The Ethics of Microfinance

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Abstract

Microfinance Institutions (MFIs) now reach 200 million people, mostly women without access to mainstream financial services living on, below and around the poverty line, with offers of small loans. The vast majority have as their twin objectives to alleviate their borrowers' poverty and to enhance their empowerment.

The paradox of microfinance is that a number of the practices used to achieve its objectives have the unintended consequence of undermining them. The concept that links the objectives of MFIs and the dangers in its practices is the relationship microfinance has with a borrower's autonomy. The MFI intends that the loan increase autonomy by enriching and empowering the borrower. Its practices, however, can easily lead to charges of exploitation, coercion and paternalism, although in the latter case it is also argued that in certain areas they are not paternalistic enough. It is argued that these latter concepts are considered wrongful, when they are, just because of how they relate to autonomy. The structure of the thesis is thus to consider the concepts of exploitation, coercion, and paternalism and then apply these concepts to the practices of microfinance.

The thesis concludes with an empirical survey of how far microfinance has in fact achieved its objectives of poverty reduction and empowerment, in order to judge whether the infringements on autonomy incurred in its practice can be justified. It then considers the extent to which the way the benefits and burdens of microfinance fall - those whose lives do indeed go better or worse after engaging with microfinance, and by how much - affects our judgement as to whether microfinance should be supported. Finally suggestions are made as to changes to practices that could be made so as to keep the pursuit of the ethical objectives, but minimise the risk of unethical practice in fact.

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Chapter One: Introduction: Microfinance, Its Borrowers and Their Autonomy

I. Aims of this Thesis

Microfinance, the provision of financial services in very small units to the very poor who lack access to mainstream financial services provision, has become a major developmental tool over the past thirty years. It now reaches over 200 million of the world's poorest people, the vast majority of whom are women.[1] Microfinance's claim to foster development is that its extension of credit to its borrowers creates a process of enrichment for them. At the same time, the industry makes the claim that it not only *enriches* its borrowers, but that it *empowers* them. It is endorsed by UN, which has made microfinance a key tool in delivering on a number of its Millennium Development Goals, particularly the reduction of poverty and the empowerment of women.[2]

The industry uses many definitions of empowerment, but I shall argue that the essence of the industry's idea of empowerment is that it is a process by which a borrower's autonomy is increased. Microfinance can thus be seen to make a dual claim: the empirical claim that it enriches its borrowers and that it does so ethically by increasing their autonomy.

This thesis aims to examine the ethical nature of the central relationship of the microfinance industry: that between the microfinance institution (MFI) and the borrower. I will argue that there is a paradox at the heart of microfinance. It aims to increase the autonomy of the borrower through enriching and empowering her. But it aims to do so through indebting her: and furthermore by doing so on a collective basis, by making her own loan conditional upon her taking liability for the debts of others. Credit is a dangerous tool to use to try to raise a person from poverty: used successfully it can indeed leverage a productive enterprise and enrich: used badly, it can just as easily impoverish and disempower. And lending collectively immediately transfers the interest of the MFI from being in the outcome for the individual borrower, to being in the collective outcome for the group. I shall argue that the *practices* of microfinance, the effects of how it is exercised, serve in fact to undermine the borrower's

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[1] Jan Maes and Larry Reid, *State of the Microcredit Summit Report* 2012, Washington DC: Microcredit Summit Campaign p. 3

[2] These two goals are interpreted specifically as aiming to raise 100 million families above the US $ 1.25 a day threshold, and as achieving greater financial access for women, larger numbers of female children of microfinance clients attending school, and greater access to health insurance and medical services

autonomy. The paradox of microfinance is that the ways in which it seeks to interact with its borrowers compromise just what it aims to enhance: borrowers' autonomy.

The concept of autonomy is woven through this thesis not only because of its centrality to the goals of microfinance providers, but because it is how an MFI's interactions with a borrower relate to her autonomy that determines whether that form of interaction is prima facie wrongful or not. The spectrum of ways in which these interactions can be classified ranges from persuasion through manipulation, paternalism, exploitation and coercion to compulsion. There are doubtless other shades of ways of classifying some interactions, and other shades of influence as well. This thesis will concentrate on exploitation, coercion and paternalism because these turn out to be of most relevance to the relationship between microfinance institutions and their borrowers. A wider study of all the ethical issues raised by microfinance would go further: it would consider whether some microfinance institutions wrongfully manipulate their donors with false claims made in marketing materials; or whether some funders of MFIs do not exploit their own backers by not disclosing what rates are truly being paid: and a full study of the ethics of the microfinance industry would consider the prevalence (or otherwise) of corruption in the industry. For space reasons, and because this thesis is principally concerned with the ethical standing of the relationship between microfinance institutions (MFIs) and their *borrowers*, these wider issues will not be discussed further here.

This thesis focuses, then, on the ways in which a microfinance institution interacts with its borrowers and the extent to which some of these practices are exploitative, coercive and paternalistic. It is the relationship of each of these concepts to autonomy that defines whether they are prima facie wrongful or not. It is then a further question as to whether, when a prima facie wrongful intervention takes place, it can be justified or not. The approach of this thesis is a value pluralist one: a prima facie wrongful intervention can be justified if the positive benefit in terms of other values, including the overall welfare that flows from it, outweighs the wrongness identified. There is thus a tension arising throughout the thesis between the importance given to autonomy, which is high, and the fact that infringements upon it *can* potentially be outweighed if the outcome of the intervention is beneficial enough. It is held that there is no inconsistency between placing a very high value on autonomy, but yet allowing that it is not the *only* value, and that it *may* be possible to justify its usurpation, restriction, even overriding of altogether, *if* the consequences in the widest sense are sufficiently beneficial. Perhaps unsurprisingly, this tension is at its clearest in Chapter 6, where paternalism is discussed, where the same tension is found in Mill.

The spectrum of classifications of various interactions between agents, from persuasion to compulsion, is not rigid. The worst forms of prima facie wrongful exploitation could be worse than mild cases of prima facie wrongful coercion. And not all forms of one party influencing another are prima facie wrongful at all. Nothing much hangs on the order in which the different classifications of interaction and influence are presented here: what does matter is the assessment of whether microfinance's interventions with its borrowers *do* amount to prima facie wrongful interactions and whether the positive consequences held to flow from them *do* outweigh their prima facie wrongfulness.

Chapters 2 – 7 of this thesis look at whether an MFI's relations with its borrowers involve exploitation, coercion and paternalism, defining each concept and then applying it to the practices of microfinance. Chapters 2 and 3 look at exploitation. Exploitation is defined as the taking advantage of an agent, or some attribute or circumstance of hers. Not all taking advantage of agents is held to be wrongful, and so exploitation itself is not held to be prima facie wrongful. It is argued that it *is* prima facie wrongful when the object of exploitation is controlled or manipulated in some way; when a benefit is derived from the exploitee which typically, but not always, accrues to the exploiter, and when the advantage of a person that is taken lies in the taking advantage of a particular sort of vulnerability – the exploitee's low level of autonomy. It will be argued in Chapter 2 that that low degree of autonomy can be either local, in a particular instance, or global, in the sense of being the entirety of an agent's circumstances; and that the exploiter does not have to have created those circumstances himself to wrongfully exploit, but may simply take advantage of them. Moreover, whilst an agent is either prima facie wrongfully exploited or not (she cannot be partially exploited), the degree of wrongfulness of the exploitation may be seen to be scalar to the degree of the lowness of the autonomy taken advantage of.

In Chapter 3, microfinance will indeed be found to be prima facie wrongfully exploitative when it takes advantage of a borrower's low global degree of autonomy: in those circumstances, its defenders have to make the case that the loan's beneficial impact for the borrower is such that this outweighs the prima facie wrongfulness of the exploitation. It exploits in several respects. It often exploits through the interest rate charged. This is not a new criticism of microfinance, but those making it to date have been unable to lay out what a ‘fair’ rate would be. This thesis does so by identifying this as the rate that would *not* take advantage of a borrower’s vulnerability, when that vulnerability arises from her low degree of global autonomy, and specifies what that would be. It is also held that microfinance exploits its borrowers through its imposition of the conditions of group liability and ‘compulsory savings’ on borrowers. There are also particular circumstances in which the microfinance institution can be seen to be complicit in the use of child labour. The case for the beneficial impact for the borrower of microfinance (which is examined in chapters 8 and 9) has to be very strong to overcome the extent of the prima facie wrongful exploitation identified in chapter 3.

Chapters 4 and 5 look at coercion and the extent to which it is practised in microfinance. Coercion is held to infringe an agent’s autonomy by imposing on the agent a limited set of options from which the agent is compelled to choose, a set which the coercer has chosen and enforces. The infringement of autonomy will typically be prima facie wrongful, but capable of justification if it results in much greater good or avoidance of harm to the coercee than the harm of his loss of autonomy.

Within the field of microcredit, the use of the group liability model (explained in Section III below) for loan repayment can be seen to have an inbuilt tendency to become coercive, and in circumstances where the borrower has not agreed in advance to this particular sanction. It will be argued that this tendency toward wrongful coercion could be avoided by a move by all lenders to individual lending, or at least individual liability within a group lending practice.

At a further extreme, the coercive pressure MFIs exert on groups of borrowers through the group liability model can lead some within that group to use compulsion on a defaulting borrower whose payment they have to meet. Compulsion is the use of brute force by one agent on another to oblige him to act in a particular way: it obliterates the autonomy of the compelled agent, making it prima facie wrongful. Chapter 5 will consider cases where the MFI coerces the group of borrowers to help it collect payment from a struggling borrower by imposing the option set: cover her payment or receive no more loans yourselves. The group may then themselves coerce the struggling borrower by, for example, threatening to take possession of her remaining assets – pots, pans, tin roof – unless she finds the repayment herself. Or they may move straight to compulsion and take these things for themselves, to compensate themselves for making the defaulting borrower’s payment for her.

Chapters 6 and 7 look at paternalism and the extent to which it is used (and not used where perhaps it should be) in microfinance. Paternalism infringes on an agent's preferences, and usurps his autonomy, against that agent's wishes, for that agent's own good. The infringement is prima facie a wrong to that agent, but it can be justified, when either the autonomy itself that is imposed upon is only partial, or when the degree of infringement of a fully autonomous agent's autonomy is very low, and the potential good achieved for the agent is high, such as with laws making the wearing of seat belts compulsory – a relatively trivial infringement of an agent's autonomy with the potential benefit of saving his life.

The exercise of paternalism, justified or otherwise, in the field of microcredit, turns out to be surprising. Some practices claimed by the lender to be examples of justifiable paternalism turn out not to be paternalistic at all, but are simply for the benefit of the lender. Some probably are examples of justifiable paternalism, such as the insistence on the borrower undergoing training before being given access to a loan, but the evidence base for the justification is weak. More controversially, I shall argue that there are some practices – such as the assessment of margins available on a borrower's proposed business, transparency with regard to the actual interest rate charged and a cash flow analysis of the borrower - that are largely absent from many lenders that would not only be examples of justifiable paternalism, where they are imposed against the borrower's wishes, but are in fact required by a currently unrecognised duty of care owed by the MFI to the borrower.

Throughout Chapters 2 to 7, particular practices are indeed found to be prima facie wrongful cases of exploitation, coercion and paternalism – but these practices could yet be justified if microfinance does indeed, overall, enrich and empower its clients. Chapters 8 and 9 consider, then, the extent to which microfinance does in fact deliver on its promises, and finds evidence that it does so wanting. Chapter 10 then lays out what we know of how the benefits and burdens of microfinance fall. It is left to the different philosophical approaches of the reader to determine if the current distribution of those benefits and burdens, to the best that we understand them, is morally acceptable – but it is hard to identify any philosophical approach that would find them so. I end by considering what changes could be made to microfinance's practices so as to increase the chances of successfully enriching borrowers and eliminating the worst of the disempowerment: how to practice microfinance rather more ethically with regard to its interactions with its borrowers than at present. I will argue that putting the concept of respecting the individual borrower's autonomy back at the heart of how microfinance is practised, as well as at the heart of its theoretical aims, will in fact produce the best overall consequences for the borrowers.

The remaining two sections of this Introduction serve to provide the basis for the chapters that succeed it. The following section aims to lay out an explanation of what microfinance is and how it works. The final section aims to define the concept of autonomy in order to draw on that definition when subsequently considering exploitation, coercion and paternalism, so that all of these concepts can then be applied to the practices of microfinance.

II: What Microfinance Is

Microfinance, broadly, is the provision of financial services in very small units to the very poor, who are otherwise typically excluded from access to mainstream financial services. It divides into the offerings of microsavings and microcredit. Microsaving is the provision of savings accounts as a way of smoothing the financial flows of the unbanked. Microsaving itself raises few ethical issues beyond the cost of the provision and the risk of the provider absconding with the savings. Microcredit is the provision of very small size loans to poor borrowers. The vast majority of the expansion in microfinance in the last few decades has been in microcredit, which is frequently offered alone, as the regulatory hurdles to offer microsavings are typically much higher. Following industry practice, microfinance will be the term most commonly used here, but it should be borne in mind, and the context will attempt to make clear, that this generally means microcredit.

Most of the ethical issues raised by microfinance are raised by the practice of offering microcredit, simply because credit – debt – is a double edged sword. Credit can both empower the borrower by enabling her to start a business whose profitability alleviates her poverty, or it can exacerbate that poverty if the business entered into with the credit fails to flourish and the interest rate payments become burdensome or even unmanageable. Although there are certainly issues of financial exclusion amongst the poorest in developed countries, microfinance has predominantly grown in developing countries, particularly in Asia, South America, Eastern Europe after the fall of the Berlin Wall, and more recently, Africa. This is not to suggest that it does not exist in developed countries, but the practices discussed below have generally been developed in emerging economies.

Microcredit, then, is the provision of small size loans to poor borrowers, typically at higher interest rates than a traditional bank charges, but below those of a moneylender. It is typically offered to women, in groups, because women are seen as safer credit risks. It is made without collateral, but with the commitment of the group to repay the loan on behalf of an individual if one defaults, the so-called 'group liability' model. Classically, repayment levels are very high – 94% and above[3] – but as they need to be if the model is to function either without further capital injection, or without still higher interest rates than those already being charged. This high, 94%+ number, has often been taken as indicative of the fact that microcredit must be working for its borrowers, or they would not be repaying and coming back for more. It will be seen in Chapter 3 that this is a mistake.

There are variations between different microcredit operations. Some now offer individual loans without group liability, and some are able to offer savings as well as credit and so have a full microfinance offering. However the most widespread model is based on that of the Grameen Bank in Bangladesh, especially its original, simple group liability model. This is not least because, following Grameen's success, others have set out to replicate its practices, and Grameen has been proactive in helping others to do so. It is worth briefly discussing the early history of Grameen, because of the inspiration it has provided to its many replicators.

Grameen Bank had its origins in 1970s when Professor Muhammad Yunus was head of the economics department at Chittagong University. In 1974 Bangladesh was in the grip of famine, and Yunus had 'started to dread my own lectures. What good were all my complex theories when people were dying of starvation on the sidewalks and porches across from my own lecture hall?'[4] Yunus began to study poverty from the bottom up, in the rural village of Jobra, close to the University. The key moment for him came in 1976 when he met Sufiya Begum, who wove bamboo baskets for a profit of two cents a day, on which she tried to feed her family. The amount of money she made was determined by the *paikars*, the middlemen who supplied bamboo at its cost price of 22 cents on the condition that the completed basket was sold back to them at 24 cents. Begum did not have enough capital of her own to buy her own bamboo and believed that the cost of borrowing from the local moneylenders to do so (at interest rates that could vary from 10% a week to 10% per day) was even more prohibitive than the deal with the *paikars*.

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[3] See, for example Bert D'Espallier, Isabelle Guérin, Roy Mersland, 'Women and Repayment in Microfinance: A Global Analysis' (2011) *World Development* vol. 39, issue 5, pp. 758-772

[4] Muhammad Yunus, *Banker to the Poor*, (1997) New York, N.Y.: Public Affairs, Introduction p. viii

It was the fact that Begum could only make two cents a day that shocked Yunus.

> In my university courses, I theorized about sums in the millions of dollars, but here before my eyes the problems of life and death were posed in terms of pennies…I was angry, angry at myself, angry at my economics department and thousands of intelligent professors who had not tried to address this problem and solve it. It seemed to me that the economic system made it absolutely certain that Sufiya's income would be kept perpetually at such a low level that she would never save a penny and would never invest in expanding her economic base. Her children were condemned to live a life of penury, of hand-to-mouth survival, just as she had lived it before them, and as her parents did before her. I had never heard anyone suffering for a lack of *twenty-two cents*…Should I reach into my pocket and hand Sufiya the pittance she needed for capital? That would be so simple, so easy. I resisted the urge to give Sufiya the money she needed. She was not asking for charity. And giving one person twenty-two cents was not addressing the problem on any permanent basis.[5]

These comments by Yunus contain the key elements that have driven the growth of microfinance: the moral outrage at perpetual poverty; the belief that access to fairly-priced capital (undefined here) could enable a borrower to earn her own way out of it; trust in the borrower to repay despite an absence of collateral, and the belief that the offer of credit should be done on a profitable or at least sustainable (at breakeven) basis, that it should not be charitable; and the belief that the borrower should, with help, be doing it for herself: that she can raise herself from poverty if only given the chance.

Yunus gathered data on all those in the village who needed access to credit in the way that Begum did so that they could then sell their produce at full retail price rather than at a rate set to give them just enough to survive, but which reserved the entire margin for the middleman. Twenty seven dollars was enough to provide all the capital necessary for forty two people. His original intention was not to set up a bank himself: he went to his local bank to see if they would lend to the poor in their own area, and was laughed away with the objection that the bank could not possibly lend to the destitute: the small amounts required would not even cover the cost of filling in the loan documentation, the borrowers were too illiterate to fill in any forms, and, most of all, they had no collateral. Thus he founded Grameen Bank instead.

For Yunus,[6] an important part of the provision of micro credit has been not just for women to begin to move out of poverty, but that in the process of doing so for themselves, by their own efforts, they become empowered socially as well as economically. It was hoped that their own access to credit and therefore the means to make a living would strengthen their position in a society which had traditionally denied them this access. A further important part of this

[5] Ibid. p. 48
[6] As it was for BRAC and, originally, ASA, two other NGOs founded in the years after Bangladesh's independence to provide credit and other services.

model is, of course, that the capital lent is in fact repaid, and is then recycled to new borrowers, so that the one unit of capital lent can have multiple effects over the years in helping borrowers out of poverty.

The empowerment objective of modern microfinance was just as important to its early creators as the enrichment objective. Examples of how the industry and the World Bank define empowerment are given in chapter 9, but to summarise them here, empowerment is the process of increasing the assets and capabilities of an individual in order for her to be able to make choices that can be translated in to action. Empowerment is the process of giving people the ability to make the choices that enable them to determine how they live their own lives.

This turns out to be is a substantial part of how the requirements for autonomous agency are defined. An autonomous agent will be seen to require positive as well as negative freedom; to have some freedom of choice and access to the basic goods of life in order to be able to achieve self-determination. Empowerment for microfinance, then, though not usually cast in these terms, is very much a process through which an agent can increase the level of her global autonomy.

Grameen Bank now has just over eight million borrowers, 97% of whom are women, and has disbursed some US $11.35bn over its lifetime with an annual disbursement of currently approximately $1bn.[7] The growth of the bank, and Yunus's advocacy, were important in 2005 being declared the Year of Microcredit by the U.N. In 2006 Yunus and Grameen Bank were awarded the Nobel Peace Prize, the Nobel Prize Committee observing that microcredit was 'a liberating force in societies where women in particular have to struggle against repressive social and economic conditions'.[8] [9]

The microfinance industry as a whole has grown even more dramatically than Grameen Bank, particularly since the 1990s with the rise of commercial, for-profit microfinance institutions. To be profitable, or at any rate self-sustaining, an MFI needs to grow as large as possible to achieve economies of scale. From the 1990s on, then, the need for commercial

[7] www.grameen-info.org/index.php?option=com_content&task=view&id=26&Itemid=0, accessed 9/10/2012
[8] 'The Nobel Peace Prize 2006 - Presentation Speech'. Nobelprize.org. 9 Oct 2012, available at http://www.nobelprize.org/nobel_prizes/peace/laureates/2006/presentation-speech.html
[9] Very recently, the Bangladesh government led by Sheikh Hasina has forced Yunus from office and looks set to effectively take control of Grameen Bank, which if it causes savers with the Bank to withdraw their savings, could bring on a liquidity crisis and the Bank's failure. This could also occur if, as some speculate, it is her intention to forgive borrower debt in advance of the next electoral cycle. This thesis however will focus on the ethics of microfinance and how it is practised, and will not extend any further into the politics of it as well.

MFIs to be profitable and not-for-profit MFIs to be sustainable has seen something of a shift in focus by the industry from the impact of microfinance on the individuals lent to, to their own organisational growth, achieving organisational stability through volume in lending.

Based on the Grameen model, the mission of a typical microcredit operation is to provide credit to poor, rural women for them to use their own energy, knowledge and skills to reduce their poverty and empower their life choices. It would have the following features: -

1. Lend only to women, in groups of 5 – 20

2. A simple, standardised loan product with regular, small repayments. The loan is often for three or four months, sometimes up to a year, and is renewable once repaid. The rate charged varies enormously around the world, from Grameen's approximately 20% to well in excess of 100% with all additional charges included.

3. Basic business training in advance of loan being made. There is generally a stress on loans only ever being used for investment/working capital, never for consumption. In practice, money being fungible, this cannot be guaranteed, but nonetheless it is an important principle in training.

4. Weekly or fortnightly repayment meetings where the group meet together for repayment, possibly training, and to raise any issues with the loan officer.

5. The Group Liability Model. Groups take collective responsibility for loans. Classically, this is through explicit joint liability, where each borrower in a group undertakes to make the repayments of any other member of the group if she fails to. It can also work informally whereby no one in the group is extended a new loan after the first cycle if any one member of the group has defaulted during it. This is regarded as essential for high repayment rates and also acts as a peer screening process. It can, of course, also be seen as potentially coercive.

Small scale collective saving and lending has existed for centuries, but contemporary microfinance using the group liability model and capital from outside the group itself emerged in the 1970s. From the outset of this modern emergence, microfinance has fused a poverty alleviation goal that is measured in consequentialist terms – *do* borrowers become better off, *do* more children of borrowers go to school – with an emphasis on the individual borrower as the means of bringing these goals about, empowering her in the process. Microfinance in Bangladesh, and through its replicators since, began with the individual (usually a woman) at the centre: it was about increasing her capability to solve her problems for herself.

But there is an ambiguity at the heart of microfinance. It aims to enrich and empower. But as noted above, the tool it uses to try to do that with, credit, is a double edged sword. Credit is, after all, simply debt: used well, it can start, expand and leverage a productive effort to generate wealth. Used unsuccessfully, it can lead to a debt spiral ending with the borrower worse off than she began, or in worse cases, ostracized from her society and even resorting to suicide. The principal charges that can be levelled against microcredit are that the offering of it is, or can be, exploitative; that loan collection practices are, or can be, coercive; and that the way in which it is typically practiced is paternalistic – although it will also be argued that in some instances it is not paternalistic enough. Trying to harness the creative force of credit whilst avoiding its worst risks when working with those in deepest poverty already, is a dangerous game. Perhaps it can only succeed with a very close eye kept on the different impacts the offer of credit has on the autonomy of the individual who is the subject of the offering. The following section, then, defines how autonomy is used in this thesis.

III. Autonomy

The core concept of personal autonomy is of being one's own person, of being self-directed. The autonomous person is one in charge of his choices, action and will. He sets his goals in accordance with his own, personally adopted, values, from a range of options; and has some possibility of achieving them. He will inevitably have been subject to some outside influence on both values and goals, if only through his genes and upbringing: quite how much external influence would be enough to undermine his autonomy will be discussed below. The autonomous agent has both positive as well as negative freedom. He not only has the capacity to form a life plan and a degree of self-awareness in choosing the values by which he does, but access to a range of options to be able to do so. This idealised picture of autonomy, then, comprises both internal and external elements; the mental capacities to be self-aware, to form plans, to reflect; and the external capacity to exercise one's life plan, to be engaged in one's own development.

This account of autonomy is in the tradition of theorists such as Mill and Raz for whom autonomy is a key ingredient in well-being, because it is necessary for the ideal of self-creation. For Raz, 'The ruling ideal behind the ideal of personal autonomy is that people should make their own lives.'[10] Raz's concept of an autonomous person is one who is 'part author of his own life…A person is autonomous only if he has a variety of options available to him to choose from, and his life became as it is through his choice of some of these options.'[11] Raz allows that some goals may be biologically driven, some may be drifted into, and some may have been deliberately chosen. What matters is that they are now an agent's own goals: they play 'a conscious role in his life.'[12]

Autonomy is presented here as a key ingredient for well-being because of its necessity for the project of self-creation. That project is meant modestly. It does not require that the project of self-creation be at all times the most important thing in a person's life. The project has a high value, but not a 'trump' value. I may not want to be the sort of person who tells lies. But there may be circumstances where the outcome for others is so drastically worse if I do not tell this particular lie that the value I place in my own self-creation is outweighed.[13]

This account of autonomy will look first at the requirements for autonomous agency, and then the requirements for autonomous action. The key requirement for autonomous agency is a threshold level of rationality, which in turn requires a capacity in the agent for self-awareness and self-reflection. The requirements for autonomous action are that one's acts are self-determined, which requires rational agency sufficient to set one's own goals, opportunity sufficient to be able to choose an action, and freedom of choice in choosing it.

(a) The Requirements for Autonomous Agency

There is a threshold level of rationality needed to be regarded as autonomous at all. Rationality is meant here as our ability to choose appropriate means to ends. To meet this threshold, an agent needs enough self-awareness to conceive of himself as a unique physical and conscious identity in the world. Without that, there would be no collection of physical and conscious experiences on which to reflect, interpret and envisage a future for. Raz

[10] Joseph Raz, *The Morality of Freedom* Oxford: Clarendon Press 1986, p. 369
[11] Ibid. p. 204
[12] Ibid. p. 291
[13] For example, faced with your threat to use nuclear weapons against my country, I lie that I would retaliate if you do, thereby preventing the attack.

stresses the need for a person to have awareness of himself as existing over time. The autonomous person uses his rationality to make choices: to choose he needs to be aware of his options, and, as Raz puts it, if 'these are to include changes in pervasive aspects of one's life, as they must if the person is to count as an autonomous person, then the autonomous person must be aware of his life as stretching over time.'[14] The autonomous person is 'marked not by what he is, but by how he came to be what he is.'[15] We have, and develop, these elements of autonomous agency to different degrees: but those without any rationality, self-awareness or ability to reflect, we will not count as autonomous. Rationality is a necessary condition of autonomous agency because without the ability to match means to ends, our attempts at self-determination could simply be self-defeating.

(b) The Requirements for Autonomous Action

For an agent to be autonomous, it is not enough that she be a rational individual. Autonomy must also be seen as embodied, as being practiced, as being a matter of action, in order to have meaning. Autonomy involves not just choosing who we want to be and how we want to live, but being that person and living that way. Autonomous agents have to exercise their capacity to determine their lives: autonomy has to be executed to have meaning.

An autonomous agent must have negative liberty, a freedom from constraints that prevent her determination of her life's course. But she also needs to have opportunities to choose from: genuine alternative ways to earn an income, or to find a partner and form relationships, or to gain an education. There may not be many alternatives, but there must be some, and a genuine freedom of choice amongst such as exist. Cultural norms that require her early marriage to a predetermined partner leave her with a very low degree of autonomy in this area of her life, even if she has more in others.

For an agent to be able to act autonomously, she needs the opportunity to access the basic goods of life: ideally an education, food, shelter and the means to make a living. She needs both opportunity to access them, and the opportunity to exercise choice regarding her means of obtaining them. Without access to such basic goods, although an agent may possess

[14] Ibid. p. 371
[15] Ibid. p. 391

rationality enough to be autonomous, her ability to act autonomously is severely circumscribed.

The case for including financial resources in the positive liberties required for autonomous action is well made by Robert Young: 'Suppose R to have substantial financial resources at his disposal and S to have much less. R is able to choose a life-plan which would involve him spending large sums of money on, for instance, travel, entertainment and the other desirable trappings of life. S is unable to choose. Whether or not R chooses thus to spend his money, he (unlike S) has the option. R is to that extent better able to live autonomously. Insufficient resources do restrict autonomy. Hence it is reasonable to accept that external negative constraints may diminish autonomy...A purely 'negative' conception (of absent constraints) leaves out the positive element of self-determination essential to an adequate account of autonomy.'[16]

It seems reasonable to suggest that a person growing up in the developed world may well have a much greater capacity to exercise her autonomy than her counterpart growing up, uneducated, in rural poverty in sub-Saharan Africa. But whilst there may be highly ranging degrees of autonomy, is there a level at which external conditions are so bad that an autonomous agent cannot act autonomously at all?

Perhaps, but this level will be very low. We would really be describing the life of a human workhorse, or a slave, or possibly a child solider taken from his village when young and with no opportunity to choose a different life before his own is over. The threshold, then, to regard someone as having enough external freedoms to be regarded as acting autonomously at all is very low – access to the barest minimum of the basic goods of life in terms of food, shelter, the ability to make a living. Total denial of these – prisoners held in starvation conditions – would fail the external threshold test for autonomous action, although of course some autonomous agency might still be available.

(c) Autonomy in Degrees

The implication of this account of autonomy suggests also that how much autonomy we have and can exercise varies not only across the different living conditions of different countries

[16] Robert Young, *Personal Autonomy: Beyond Negative and Positive Liberty* (1986) London: Croom Helm p. 49

and continents, but within the lifespan of a single person. That seems a natural conclusion: as children, we have less autonomy than as young adults, for rationality has not fully developed; as we get older, our ability to act autonomously, having peaked, may diminish, simply because there will not be enough time left in life to develop all the life plans we might want to: and because our physical capacities decline and with it our ability to execute all the plans we might still be capable of forming.

Degrees of autonomy, then, follow the natural curve of a human life, and will vary enormously with the social, economic and political circumstances into which that life is born. Of course, what is standard in terms of external living conditions and therefore capacity for the exercise of autonomy is much greater in some countries than in others. With the threshold for basic conditions set very low, most people with mental capacity and physical freedom in the world will meet the conditions for being minimally autonomous: those in countries of high education and standards of living will of course have very much more of it than those without. That, however, is just recognition of reality.

We are more or less autonomous to more or less varying degrees in many different aspects of our lives. Gerald Dworkin observes that 'autonomy seems intuitively to be a global rather than a local concept',[17] but it is, perhaps, rather both: we can consistently think of an agent having a high degree of autonomy of action in general, but not in one particular area (perhaps he is deaf); and a high degree of autonomous agency in general (he is rational, thoughtful, knows what he wants and how to achieve his goals in general), but not in an especial area (his inability to fulfil his desire to quit smoking.) We can, then, distinguish global from local autonomy of both action and agency. Global autonomy is the level of autonomy that reflects the scope of autonomous action across many areas of our lives, and a rational agency that enables self-determination; local autonomy reflects how a person can determine how to act and actually act in a particular situation. Martha Nussbaum and Amartya Sen, in their accounts of what positive freedoms are required for a life to flourish, look at our capabilities in many different areas,[18] but the point here is not to provide a definitive list, as new areas

[17] Gerald Dworkin *Theory and Practice of Autonomy* (1988) Cambridge: Cambridge University Press p. 16
[18] Nussbaum summarises the capabilities she regards as central in *Creating Capabilities* as, at a bare minimum, the ten Central Capabilities of Life; Bodily Health; Bodily Integrity; Senses, imagination and thought; Emotions; Practical reason; Affiliation; Other Species; Play; and Control over one's environment, both political and material. Martha Nussbaum *Creating Capabilities* (2011) Cambridge. Mass.; London: Belknap Press p. 33-34

can be debated and added.[19] Nor is the point to adopt the capability approach as a multilayered definition of what it is to be autonomous. It is rather to draw out that just as Nussbaum finds many different aspects to what enables a life to go well,[20] so the capacity for the exercise of autonomous agency is measured in its many different capacities.

Wolff and de Shalit describe Leah, whose life is controlled by her family, and the men who marry and abandon her, and her father who insists she marry for a third time to avoid 'shame'. She has no education. As Wolff and de Shalit put it: 'She is humiliated by the community, by the men who have power over her, and by her indigence. She has no proper education. She cannot be autonomous.'[21]

Their concept of autonomy here is control over your own life. Yet rather than conclude[22] that Leah is not autonomous at all, we can look at what scope for exercising her autonomy she still has. A person may still have some autonomy even if under considerable social or cultural pressure: a Muslim woman who feels obliged, or simply wants to, follow the practices of veiling and purdah, may have some autonomy of action in her private life even when a public life is denied her. When we come to apply the concept of autonomy to the practices of microfinance, we may feel that exercising any particular mode of influence over a woman such as Leah might be deemed right or wrong according to whether it touches on an area of her life in which she has a high or low degree of autonomy. For example, I will argue that a borrower's low degree of autonomy in terms of her financial inclusion will be what makes an exploitative interaction with her with regard to lending prima facie wrongful. Pigeon holing her into being 'overall' autonomous or non-autonomous may miss the distinctions between which modes of influence over her are acceptable and which are not.

Oshana presents us with the challenging example of whether a person can be autonomous and voluntarily become non-autonomous.[23] She imagines a woman living under the Taliban

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[19] Wolff and de Shalit convincingly argue in *Disadvantage* that we could add to the list a person's prospects for sustaining the levels of functioning he has already achieved, and how exceptional risk and vulnerability is itself a disadvantage (whether or not the feared event actually occurs) that undermines one's ability to 'do and be'. Jonathan Wolff and Avner de-Shalit, *Disadvantage* (2010) Oxford: Oxford University Press. Nussbaum notes in *Creating Capabilities* that she is quite happy to accept revisions to her list, and this one in particular.

[20] and Wolff and de Shalit find disadvantage (the opposite – what can make a life go badly) equally plural

[21] Op. cit. note 19, p. 2

[22] And I do not mean to suggest that Wolff and de Shalit necessarily reach this conclusion. They do not state whether they regard Leah as having the capacity for autonomous agency and may simply assume that she does, and mean by stating that she cannot be autonomous only that she cannot live and act autonomously, because power over many important external acts for her is exercised by others.

[23] Marina Oshana 'How Much Should we Value Autonomy?' (2003) *Social Philosophy & Policy Foundation,* vol. 20, issue 02, pp. 99-126

regime in Afghanistan, previously a physician, who now embraces a subservient role and lack of independence expected of women by the regime, and does so voluntarily out of religious belief. She can now no longer practice medicine, support herself financially, dress publicly other than in a burqa and so on; but 'a life of subservience is consistent with the Taliban woman's spiritual and social values, provides her with a sense of worth, and satisfies her notion of well-being.' For Oshana, the Taliban woman clearly 'is not autonomous. In a 'local' or occurent sense of the term, she has chosen autonomously. Nevertheless, she fails to be autonomous in a 'global' sense for the reason that the life that she chooses, and toward which she experiences no alienation, is a life in which she is systematically subject to the ultimate will of others. Although the Taliban woman is 'master of her will' – her original decision was made autonomously, she willingly renounces her rights, and she continues to express satisfaction with the life that she has selected for herself – she now has no practical authority over her situation…Although the Taliban woman does what she wants, what she wants frustrates the exercise of autonomy.'[24]

Oshana contrasts the Taliban woman's situation to that of a monk. The monk retains control over his decision to be subservient: he could leave the order; he can recall his ability to lead a different sort of life. One can autonomously decide to restrict one's autonomy, but cannot renounce it and remain autonomous, any more than one can sell oneself into slavery. If the situation of the Taliban woman is so extreme as to be the equivalent of selling oneself in to slavery, then she has placed a higher value on religious observance than she has on autonomy and ceases to be autonomous.

We may hesitate to agree with Oshana, however, that willingly submitting to the strictures of a Taliban regime really is quite the same as giving up control over all aspects of one's life, so that we may feel that, like Leah, the Taliban woman lacks substantial amounts of autonomy, is perhaps only partially autonomous, but is not wholly non-autonomous. The Taliban woman, after all, retains the requirements of internal autonomy; she continues to reflect, and be happy with her choice. She has lost a great deal of autonomy of action. She is an autonomous agent who has little (but not no) autonomy to act: but only if she had no autonomy of action at all might we say she was non-autonomous.

In Chapter 9, we meet a real example of a woman who takes out a microcredit loan in order to run a small microenterprise from home, just in order to be able to observe purdah. As one

[24] Ibid. p. 104

of the very poorest in society, she had previously to work in the fields as a day labourer, not observing purdah because it was incompatible with carrying out her work. That put her in the lowest of social classes. The microfinance loan enables her to choose purdah and be happy in her choice. Do we really want to argue that she has become non-autonomous? Rather, she has autonomously chosen a lifestyle which restricts some autonomy of action which she values less than the social status associated with purdah. We may disagree with this choice, but this individual is not non-autonomous.

This picture is complicated, however, by other instances of women taking out loans and then adopting purdah, but very much at the insistence of their husbands. In these cases (also examined in Chapter 9), the husbands coerce the wives in to taking out loans (the MFIs will not lend directly to men) and use the proceeds to both fund microenterprises and to buy the garments of purdah for their wives. There is little room for autonomous choice for the women anywhere in this particular picture, although she may be allowed greater independent mobility by her husband once purdah is adopted. This complex picture reflects the very many different degrees of autonomy an agent may have. The female entrepreneur who chooses purdah gives up a degree of autonomous action, but finds that compensated for by an increase in her social status and, presumably, greater happiness in living in a style in accordance with her beliefs. The woman who is forced into purdah has a low degree of autonomy indeed, not even being able to choose voluntarily to restrict her autonomous action. It still seems worth, though, when interacting with her, establishing whether the interaction takes place in an area where she does still have a degree of autonomy or not, however few these are.

One is autonomous with regard to many different aspects of one’s life, then: the common factor is the ability to set one’s own direction, whether it be in work, play, social life etc. If an individual lacks the capacity to be self-directed, she cannot be autonomous in anything. So whilst we disagree as to whether Leah, or Oshana’s Taliban woman, or the borrower who chooses purdah is autonomous, we all agree foetuses, infants, the comatose are not, because they lack rationality and self-reflection, the capacity for self-direction, in any area. (That is not to judge whether we have moral responsibility to them or not, only to say that if we do, it will not be on grounds of currently existing autonomy.)

Whilst there is a threshold level of rationality for autonomous agency, there cannot be a threshold for autonomous action in each external aspect of our lives, because a person lacking freedom to act completely in one area remains an autonomous agent provided there is some area of external freedom through which she can exercise her autonomous agency. Impositions on autonomous agency are thus more serious than any given imposition on any given autonomous act of an autonomous agent, because, restricted with regard to one act, an autonomous agent can yet exercise her autonomy through another: but an imposition on autonomous agency risks interfering with an agent's ability to act autonomously at all.

When it comes to judging what infringements of an agent's ability to act autonomously are acceptable, if any, perhaps this will matter. We may, for example, be more prepared to justify imposing a paternalistic restriction on an individual in one area of his life when he is regarded as having a low degree of autonomy with regard to a particular act because his choice of action is based on a false belief. But these applications will take place in the chapters that follow.

As has been suggested above, it is (at least in part) the relationship to an agent's autonomy that makes some forms of interaction and modes of influence of one agent over another prima facie wrongful. Some major classifications of types of interactions and influence, how they relate to autonomy, and whether they are modes of influence used extensively in microfinance, are listed below.

Persuasion

A seeks to persuade B to act or believe differently than he previously did through providing B with reasons B can adopt and apply for himself. There is no impact on B's autonomy, unless it is to increase it by enhancing B's rational decision-making, and so rational persuasion raises no ethical issues (at least on grounds of autonomy). MFIs do try to persuade borrowers to take out loans, but while they stay within the realm of straightforward offer and transparent presentation of the terms of which the loan will be made (by no means always the case), this presents no difficulty.

Manipulation

A manipulates B when A persuades B to act or believe differently from previously, but alters something in the setup of the presentation of the facts, or works to bring about a false belief in B to do so. Manipulation covers a range of behaviour: when Iago manipulates Othello by firing his jealousy with hints and doubts, he tells no lies but plays on Othello's emotions to stir him in one direction; when he convinces Othello that Cassio has Desdemona's handkerchief and could not have come by it innocently, he undermines Othello's autonomy by instigating a false belief. Manipulation undercuts autonomy by perverting the way an agent chooses his goals or reaches a decision. There is little evidence of manipulation of *borrowers* by MFIs and for that reason manipulation as a classification will not be considered further here, although in a wider context, manipulation of donors' emotional responses to microfinance, the disproportionate promotion of 'success' stories and suppression of 'unfortunate' stories, do raise broader issues of manipulation.

Exploitation

The term exploitation is not used in a moralised way in this thesis, wrongful by definition, but is held to be prima facie wrongful when it takes advantage of a very particular sort of vulnerability – the exploitee's low level of autonomy. On the face of it, microfinance would appear to do that, hence chapters 2 and 3 are devoted to it, with a much fuller definition of when exploitation is prima facie wrongful at the start of chapter 2.

Coercion

Coercion is defined in an empirical, rather than a moralised way, here as A coercing B when A imposes a limited set of options on B from which B must choose. Coercion clearly undermines autonomy, even when it can be justified for other reasons. Aspects of microcredit, notably loan collection, certainly could be coercive, and chapters 4 and 5 pick through this in detail.

Compulsion

A compels B to act in a particular way when he uses pure force on him to make him act in that way. Compulsion is distinguished from coercion by the absence of any choice for B at all, even between two undesirable options. Compulsion leaves no room for the exercise of any autonomy at all. In microfinance, compulsion between the MFI and the borrower is rare (unlike coercion). Instances do occur (confiscation of borrowers' savings by the MFI) but it is more common between the group of borrowers or their leader and the individual borrower, arguably when coerced by the MFI to do so. For that reason compulsion is dealt with in the coercion chapters.

Paternalism

A acts paternalistically toward B when he acts against B's preferences, usurping his autonomy, albeit for B's good. The use of paternalism in the practices of microfinance is complicated, because whilst some interactions between MFI and borrower can be classified as such, and then justified or not, other interactions which are claimed by the MFI to be instances of justifiable paternalism are not in fact paternalistic at all. Chapters 6 and 7 work through this, and make the case for MFIs adopting a practice currently absent which would often be paternalistic if adopted: the exercise of a duty of care to their borrowers. Where this duty of care could only be exercised paternalistically, it will be argued that that is not only justified paternalism, but is required of the MFI.

With this understanding of the concept of autonomy, then, and the central planks of how the microfinance model works, I turn to the relationship between the microfinance institution and the borrower. I consider how the offer and practices of microfinance affect and influence the borrower and which can be considered prima facie wrongful or not by virtue, at least in part, of how they relate to her autonomy. The final chapters consider whether any such prima facie wrongful influence can be justified by its beneficial consequences, if indeed they exist.

Chapter Two: Exploitation and When it is Wrongful

This chapter examines the concept of exploitation and when in fact it is prima facie wrongful; the following chapter examines whether the offer of microfinance itself, and any of its practices, are wrongfully exploitative. I define prima facie wrongful exploitation in the following way. A wrongfully exploits B when:

(i) A takes advantage of a vulnerability of B to A;

(ii) A manipulates B in some way;

(iii) A, or a third party, derives a benefit from the transaction;

(iv) A is in a position of relative power over B in the particular circumstances of the interaction; and

(v) B's vulnerability to A arises from either a low degree of autonomy in the global sense, or a low degree of autonomy in the particular circumstances of the interaction.

This, then, is a 'vulnerability' account of exploitation, one which puts the taking advantage of a vulnerability at the heart of what is wrong with exploitation, when it is wrong. As such a 'vulnerability' account, it departs from the perhaps dominant account of exploitation, Wertheimer's 'unfair usage' account. The first parts of the criteria above are common to other vulnerability accounts: that part which links which vulnerabilities it is prima facie wrongful to take advantage of to an agent's low degree of *autonomy*, is original to this account.

This chapter will proceed, then, by laying out a broad, non-moralised, account of exploitation, and then analyse when it is prima facie wrongful. The 'unfair usage' account of when it is wrongful is examined but rejected. The vulnerability accounts of Goodin and Wood are explored and developed to explain how it is those vulnerabilities that arise from a low degree of autonomy, globally or in a specific instance, that are those the taking advantage of which count as prima facie wrongful exploitation. The chapter closes on the question of whether a prima facie wrongfully exploitative interaction can still be the right thing, overall, to do. In the following chapter I apply this theory to the practices of microcredit, to consider whether, and in what ways, microfinance institutions exploit their borrowers.

I. The Broad Concept of Exploitation

In the broadest sense, exploitation is the making use of, or turning to your advantage of, someone, something, a set of circumstances or even another's attributes, for your own purposes. In this broadest sense, it is not prejudicial. Exploitation is always done by a person: someone exploits something or someone when he takes advantage of it or him in some way: we exploit natural resources, wind power, and our own particular skill sets and attributes (brains/beauty/sports ability etc.). As Feinberg puts it:[25] 'To exploit something, in this most general sense, is simply to put it to one's use, not to waste it, and there are no limits on the sorts of things that can be exploited. Even in this general nonpejorative sense, the exploiter is always a person; diseases, landslides and tropical storms have never exploited anything.'

Exploiting something in this morally neutral sense is distinguished from merely 'making use' of something by the fact that the exploiter manipulates or controls the object of exploitation in some way. So, to take an example from Woods,[26] a hiker in the woods who takes a drink from a stream simply makes use of the stream to quench his thirst, but does not exploit it; the miller who builds a mill on it does. We do say that we exploit unpredictable circumstances as well, but only where an agent has a pre-existing plan that he takes advantage of the unexpected circumstance to further: otherwise, he just makes use of his good luck.

A benefit is often derived from the exploitation by the exploiter – that is usually why he exploits – but it is not strictly necessary for this broad, morally neutral account of exploitation (derivation of a benefit, typically but not always for the exploiter himself, will be required for prima facie wrongful exploitation.) As Goodin observes,[27] miners who extract ore from the ground have successfully exploited the seam (turned it to their advantage), whether or not they then succeed in selling that ore for a profit. But when it comes to exploiting people (and when exploitation is wrongful), it seems that the derivation of a benefit is required. However much one person or agency may manipulate or control another – such as the 'nudge' theorists who try to manipulate people in to eating more healthily by making the salads more easily accessible than the chips – we do not regard this as exploitation unless the theorist derives a personal benefit from it. (We might, of course, regard this as paternalism, see chapter 6.) For

[25] Joel Feinberg, 'Noncoercive Exploitation' in Rolf Sartorius (ed.) *Paternalism* (1984) Minneapolis: University of Minnesota Press pp. 201-235

[26] Allen Wood, 'Exploitation', in Kai Nielson and Robert Ware (eds.) *Exploitation* (1997) New Jersey: Humanities Press International, p. 7

[27] Robert Goodin, 'Exploiting a Situation and Exploiting a Person', in Andrew Reeve (ed.) *Modern Theories of Exploitation* (1987) p. 192-3 London: Sage Publications

prima facie wrongful exploitation, the benefit usually accrues to the exploiter, but it is possible to prima facie wrongfully exploit on behalf of a third party. A set of ruthless parents who deny doting grandparents access to their child unless the grandparents put all their wealth in trust for that particular grandchild to inherit when aged 25, prima facie wrongfully exploit the grandparents' vulnerability to their control of access, though they derive no personal benefit.

Attributes or circumstances of people can be exploited whilst remaining within this neutral sense of exploitation. We can take advantage of our own talents and skills, train our voices or athletic ability to benefit from a singing or athletic career, without doing anything wrong. We can also exploit the attributes of other people without necessarily doing anything wrong: Alex Ferguson does nothing wrong in exploiting Wayne Rooney's speed to maximise the efficiency of the Manchester United attack.

Do we then say that Ferguson has exploited Rooney himself? Typically, we only hold that A has exploited B himself whilst exploiting an attribute of B when we deem the exploitation to have been wrongful. 'Unfair usage' accounts of exploitation look for something unfair in the interaction to make the exploitation wrongful, 'vulnerability' accounts look for a vulnerability of B to A (however then further specified) to make it wrongful. But both agree that if the unfairness or vulnerability is present when A exploits an attribute of B, then B himself is exploited as well. One cannot be unfair to, or take advantage of the vulnerability of, an attribute. Whatever it is that makes exploitation wrongful (when it is), when an attribute or circumstance of a person is wrongfully exploited, the person is wrongfully exploited as well.

The term 'exploitation' is only used in a pejorative way when the exploiter takes advantage of, or makes use of, another person rather than a thing or an attribute of himself. And even then, this is only so in particular circumstances. For pejorative exploitation, it is necessary that the exploitation be person or persons to person: it is around the second ingredient(s) as to what makes some person to person exploitation morally wrongful, and some not, that much of the contemporary debate has occurred.

But note here that it is not that there are two meanings of the term 'exploitation'. There is a single meaning, but some uses of exploitation we find morally wrongful, and others not. As

Wood has argued,[28] the word 'exploitation' operates like 'homicide' or 'abortion' rather than 'murder': not wrong by definition, although it could be the case that all acts of exploitation are in fact morally wrong, just as some people believe that all acts of abortion are in fact morally wrong, without holding that that is so simply through the meaning of the word.

Wood does in fact believe that most person to person exploitation (as opposed to person to thing) is in fact wrong, but insists that this needs a further justification. We can see that not all person to person exploitation is morally wrongful: that on the contrary, everyday exploitation that raises no moral issues is pervasive. I exploit the services of a taxi driver when I ask him to take me somewhere; he exploits me and all those like me by making his living out of people who sometimes want to shorten their journeys or avoid the rain. The term is used neutrally here because the taxi driver and I are free to reach any price for that journey and both have options (other fares, other taxis) if we cannot reach agreement. Neither of us is a monopolist or monopsonist. Not only in this transaction do we have freedom of action and hence valid consent, but there is nothing in the background conditions or social structure in which we make our deal that either of us do, or could reasonably, object to. In the different accounts of morally wrongful exploitation that follow, all agree as to the innocence of this type of exploitation, whether because where there is such freedom of manoeuvre there is no unfairness, or because the copious number of taxis and other potential fares means that neither of us is vulnerable to the other.

To complete the ground clearance of the morally neutral, non-pejorative use of exploitation, we should consider if there are any instances of person to non-person exploitation where the term is used pejoratively. The case of animals will fall in the middle here depending on one's view of the moral status of non-human sentient beings, so here I shall just discuss non-sentient objects. I would suggest that when we speak of exploiting minerals and other natural resources, the term is typically not used pejoratively. There has become a tendency for a moral edge to come in to the use where the exploitation of the object ultimately has harmful consequences for other people. So the miner exploiting the coal seam is described neutrally up until the point where his over mining becomes unsustainable, at which point the term 'exploitation' begins to carry an additional moral edge. Where what is exploited has no interests of its own, that edge is seldom present: where it is being exploited unsustainably, it is perhaps the interests of future generations who will no longer be able to exploit it

[28]Op. cit. note 26, p. 3

themselves, that give it that edge. It could be argued that the moral edge here is not that the exploitation is now being seen pejoratively as such, but that its consequences are. But if one did wish to hold that the term is used as morally wrongful per se here, it is worth noting that the reason would appear to be because of the vulnerability of future generations, who cannot protect themselves against the loss of future resources they would otherwise have access to, that seems to be the justification for doing so.

All exploitation, then, morally wrongful or not, involves a person taking advantage of something or someone. All prima facie morally wrongful exploitation seems to be person to person with the possible caveat of person to object exploitation where the interests of other, possibly future, people are involved, and leaving to one side the question of the exploitation of animals, which would vary with the moral status that we accord them. But not all person to person exploitation is prima facie morally wrongful. What then are the characteristics of those types of person to person exploitation that make it so, when it is?

II. Distinguishing Wrongful Exploitation from Morally Neutral Exploitation

There are two major accounts of what makes exploitation wrongful (when it is) in contemporary philosophy. The first centres around the idea that a wrongful exploitation must take advantage of a person in some unfair way. The second is that wrongful exploitation takes advantage of vulnerability in a person, it being the taking advantage of a vulnerability that is wrong. The vulnerability account then splits down two lines: rooting the importance of why it is wrongful to take advantage of another's vulnerability either in a general duty of the strong to protect the weak (Robert Goodin) or in the nature of a respect that we all owe each other by virtue of our humanity (Allen Wood). I shall argue a slightly different line: that it is the taking advantage of those vulnerabilities that arise from a low degree of autonomy (globally or, in specific instances, in the local sense of autonomy) – and only those – that makes for prima facie wrongful, as opposed to neutral, exploitation.

I shall examine first what is the predominant view of exploitation, that of Alan Wertheimer, that exploitation is one person taking advantage of another in an unfair way. Note, of course, that if what was specified as being unfair in this account were itself the taking advantage of another's vulnerability, then Wertheimer's account would just dissolve in to a vulnerability account. I shall indeed argue that Wertheimer does not produce a single common feature of unfairness other than taking advantage of a vulnerability: he successfully dismisses other candidates, but his attempt to dismiss vulnerability itself fails, leaving it as in fact the only remaining common account of what makes some exploitation prima facie wrongful.

(a) The Unfair Usage Account of Exploitation

Wertheimer defines exploitation, at its most general level, as 'A exploits B when A takes unfair advantage of B'[29]. But he immediately concedes Arneson's point that such a broad account means that there will 'be as many competing accounts of exploitation as theories of what persons owe to each other by way of fair treatment.'[30] So Wertheimer needs to narrow down where the unfairness lies: he states that this could be either in the outcome of the transaction, or the process.

With regard to the outcome, he deems a benefit necessary to A, but this alone is not enough as it covers morally innocent transactions as well as morally wrongful ones. With regard to harm to B, he concludes that it is not necessary, because exploited parties can benefit more from an exploitative transaction than exploiters do. 'It is precisely because A generally stands to gain less utility than B from what might appear to be a fair transaction that A can drive what appears to be a hard bargain.'[31] This is indeed so. The poorly paid sweatshop worker nonetheless prefers that job to subsistence farming, and he both consents to the exploitation and has a higher marginal utility than if he did not take the job, so it is hard to say that he is harmed by it.

Wertheimer recognises that distinguishing what makes a mutually beneficial transaction unfair is difficult 'because there is no non-problematic account of unfair transactions'.[32] It would not seem to be because the transaction is in an 'incommensurable' good because it is not clear which goods are incommensurable, nor why exchanging incommensurable goods is necessarily unfair. And as we saw above, it seems not to be necessary that the distribution of the gain is unfair, that A gains more than B because 'if we measure the parties' gain in terms

[29] Alan Wertheimer, 'Exploitation' *The Stanford Encyclopedia of Philosophy (Fall 2008 Edition),* Edward N. Zalta (ed.), URL=http://plato.stanford.edu/archives/fall2008/entries/exploitation
[30] Richard Arneson, 'Exploitation' in Lawrence C Becker (ed.) *Encyclopedia of Ethics,* 1st edition (1992) New York: Garland pp. 350-352
[31] Alan Wertheimer, *Exploitation* (1996) Princeton: Princeton University Press p223
[32] Op. cit. note 29

of marginal utility from the no transaction baseline, the exploitee often gains more than the exploiter'.[33]

The most promising line in Wertheimer's view is that we evaluate the fairness of a transaction against 'a normative baseline as to how much the parties ought to gain' but recognises at once 'that baseline is not easy to specify.' His best hope is for a 'hypothetical competitive market', but the problem here is that many of the exploitation issues that worry us most come about precisely where the market has failed or simply does not exist. We shall see that the interest rates on microcredit are, in absolute terms, very high: but the hypothetical rate is not what banks do charge, but what banks would charge if they supported a branch network out to the areas the very poor live in. As they do not we only have a poor idea of what this rate would be.

On top of the problems of a lack of a competitive benchmark by which to measure if exploitation is occurring in some important instances, Jonathan Wolff argues that the concept of trying to use such a benchmark is mistaken in the first place.[34] He challenges David Miller's claim that 'It is generally speaking a necessary condition of A's exploiting B that, in exchange between them, A does better and B does worse than each would under equilibrium prices.'[35] As Wolff argues, this account makes two assumptions: that (i) the competitive market in equilibrium sets the appropriate norm as a benchmark for judging whether exploitation takes place; and (ii) that competitive markets (or many of them), in the long run, reach equilibrium.

Wolff challenges both claims. Whilst classical economics teaches that competitive economies tend to equilibrium, Wolff quotes Joan Robinson[36] as arguing that Marx's main point of difference from classic economists and perhaps his most important insight 'is the claim that there is no long-run tendency to equilibrium because whenever we get close, the capitalist turns to labour-saving devices to cut costs, and therefore demand for labour.' Innovation and 'shocks' mean that we are always moving toward, or away from, some fleeting moment of equilibrium: it only ever arrives briefly or if we assume that technology is for ever fixed. Having denied the second claim, that competitive markets have a long run tendency to

[33] Op. cit. note 29
[34] Jonathan Wolff, 'The Ethics of Competition' in Geraint Parry, Asif Quershi and Hillel Steiner (eds.), *The Legal and Moral Aspects of International Trade,* (1998) pp. 82-96 London: Routledge
[35] David Miller, 'Exploitation in the Market', in Andrew Reeve (ed.) *Modern Theories of Exploitation* (1987) London: Sage Publications, p. 162
[36] Joan Robinson , *An Essay on Marxist Economics* (1964) London: MacMillan, p. 11-12

equilibrium, without which the first claim fails (if we can never know what competitive equilibrium is, using it as a measure for exploitation will be fruitless), Wolff then denies the first, major, claim anyway. He does so on the grounds that no form of market can discriminate morally pertinent from morally arbitrary determinants of price. The price of labour is set by the supply of it, the demand for it, and the care and productive effort by which it is applied. All these factors are on a par if the market price for labour is automatically the fair and just price for labour. Wolff finds this implausible. He does not believe that the arbitrary factors of any given level of supply and demand can tell us what is normatively fair as opposed to market price-determined fair. If this is so, Wertheimer (and Miller's) attempts to use a competitive market equilibrium benchmark to measure exploitation cannot work. We are back to something else being required to tell us when exploitation is 'fair', or not.

In trying to locate the unfairness that distinguishes morally wrongful exploitation, Wertheimer considered that it had to lie in either the outcome of the exploitation (benefit to A or effect on B), or the process. With regard to outcome, he argues successfully that some benefit to A is necessary, even if it is just the advancement of A's altruistic goal. He rejects the wrongness lying in harm to B, however, because he regards mutually advantageous exploitation as possible. This leaves him process, that there is some defect in the process by which an exploitative transaction comes about. The major candidate for a defect in the process is that it is less than fully consensual on B's part: B is perhaps coerced or manipulated or defrauded in some way. But Wertheimer does not permit himself this route either, stating: 'By contrast with cases of coercion and fraud, there are at least some cases of alleged exploitation in which *B*'s consent is not defective in either of these ways. In many cases of alleged exploitation, *A* gets *B* to agree to a mutually advantageous transaction to which *B* would not have agreed under better or perhaps more just background conditions, where *A* played no direct casual role in creating those circumstances, where *A* has no special obligation to repair those conditions, and where B is fully informed as to the consequences of various choices. Although B might prefer to have a different range of options available to him, she can make a perfectly rational choice amongst the various options.'[37] Wertheimer leaves us hanging, then, as to where the unfairness lies. He seems to want to find it in some version of a disparity of value account that is measured by a hypothetical market baseline, but recognises that he has not yet found one.

[37] Op. cit. note 29

Wertheimer's dilemma would be resolved if he were to accept that the unfairness of morally wrongful exploitation lies in its taking advantage of our vulnerabilities, however distinguished further in some way. He does not accept this however. He argues that the unfairness must reside in something other than B's vulnerability to A. It is not that he does not accept that B will often be vulnerable to A in cases of wrongful exploitation, but he argues that this is not enough. He argues that if A makes a reasonable proposal to B that B must accept, given that in B's vulnerable situation B would accept anything, then the reasonableness of the proposal removes the question of unfairness and means that A does not exploit B. Wertheimer imagines a classic case of exploitation, where A, a seller of snow shovels in a remote area with no close competitors, drastically raises his prices in a blizzard. B, in need of a snow shovel, still wants to buy from A even at the higher price but is exploited if it is 'too' high a price. If, instead, A simply sold B a shovel at the regular price, then there would be no unfairness, so A would not exploit B.

On the basis of this, Wertheimer argues that B being vulnerable to A is not itself enough to establish wrongful exploitation. But in fact this only shows that vulnerability is not sufficient for wrongful exploitation, not that it is not necessary for it. It could be, and the vulnerability accounts discussed later argue that it is, necessary for wrongful exploitation but further distinguishing features in addition to vulnerability are required for sufficiency. A vulnerability account would agree with Wertheimer that selling the snowbound driver the shovel at the regular price does not wrongfully exploit him: here, the driver is indeed vulnerable to the shovel seller, but the seller refrains from taking advantage of it. We need to know more – do any vulnerabilities count? How is the taking advantage of specified? – but as a move to dismiss vulnerability as a necessary component in an account of exploitation, this fails.

As Wertheimer does not succeed in locating the unfairness in wrongful exploitation other than in the taking advantage of a vulnerability, however further specified, let us turn to vulnerability accounts of exploitation to try to find what marks out morally wrongful exploitation.

(b) Vulnerability Accounts of Exploitation

(i) Goodin's account

The first contemporary vulnerability account of exploitation is Robert Goodin's, which predates the accounts of both Wertheimer and Wood. He locates the moral wrongness of exploitation in the taking advantage of vulnerability. 'Using people is…a necessary condition of exploiting them. But this is not a sufficient condition. What more is required in order to make it sufficient is not the presence of harm, or the absence of consent, or the presence of coercion, or the absence of reciprocity, or some specification of the ways in which people are being used…The analysis of exploitation thus reduces to an analysis of why, and in what respect, it is wrong (unfair, exploitative) to use certain attributes of people and their situations in certain ways.'[38]

Force or coercion are not enough because, although compelling in economic circumstances, they operate weakly elsewhere. 'When exploiting friends or lovers, we are not forcing them to do anything whatsoever.'[39] The disparity of value, the notion of 'unequal exchange' is also strong in the economic sphere, but not outside it (and is also subject to all the problems discussed above in any event.) Manipulation is also dismissed, because although deception, as an element of manipulation, is often present in exploitation, this need not be so – as Goodin observes, OPEC tried to deceive nobody when openly using their near oligopoly on the supply of oil to achieve a high price for it in the 1970s.

Morally neutral exploitation, for Goodin, is the taking advantage of something, or some circumstance, distinguished from merely making use of by taking advantage of it in unusual circumstances, or in a very particular way. Exploiting a person is a special case of exploiting a situation, and occurs where one person is in a strong position of power relative to another, making the exploitee vulnerable to the exploiter. It is that power/vulnerability relationship that defines what counts as exploitation of a person, and it is exactly the same feature that makes all person to person exploitation morally wrongful for Goodin, because it breaches what he regards as the moral norm of a duty to protect the vulnerable. At this point Goodin's account of what it is to exploit a person becomes moralized (unlike exploiting things) because what marks out one person's exploiting another (as opposed to merely making use of him) is

[38] Op. cit. note 27 pp. 180-1
[39] Op. cit. note 27 p. 174

the vulnerability of one to the other: and he holds that it is always morally wrong to take advantage of that.

So for Goodin, what makes exploitation wrongful, when it is, is just the same as why it is wrongful. He notes: 'Occasions for exploitation arise when one party is in an especially strong position vis-à-vis another. These same circumstances impose upon the stronger party a heavy moral duty to protect the weaker…just as the analysis of the notion of adultery is parasitic upon an analysis of the duty of marital fidelity, so too is the analysis of exploitation parasitic upon an analysis of this duty to protect the vulnerable.'[40]

Establishing a positive duty on the strong to help or protect the weak, as opposed to the negative duty not to harm, is problematic however. There is no generally established obligation on people to help those who are dependent on them: typically, we only recognise such an obligation when an agent has done something voluntarily to incur it. We regard parents as being obliged to take care of their children because they are the result of their voluntary actions, rather than because children are dependent on their parents per se. If dependency were all, a patient awaiting a life-saving kidney transplant operation would have the right to demand a kidney from the rare match, whoever that match was, for the patient is certainly dependent upon that rare match

What Goodin does here is to try to ground a concept on which we have a strong intuition (exploitation) on one in which intuitions are weaker (the nature and extent of positive duties.) But Wood has a simpler objection to Goodin's position: that it is vulnerable to a counterexample being found where exploitation is wrongful, but no 'obligation to help' is violated. Wood provides one such: 'If I am a private detective hired by your wife to spy on you, I owe you no 'obligation to help' making it incumbent on me not to tell her about your cheating – on the contrary, I owe her the obligation to inform on you. But I do clearly exploit you in a morally objectionable manner if I blackmail you by threatening to tell her.'[41] So here, the blackmailing detective wrongfully exploits the husband, and the cheating husband is certainly vulnerable to him, but the detective owes him no duty of protection.

(ii) Wood's account

[40] Op. cit. note 27 p. 167
[41] Op. cit. note 26 p. 15

Although Wood rejects the rooting of an account of wrongful exploitation in a duty of the strong to the weak, or a duty to help, he believes strongly that a vulnerability account is the correct one. But it should be rooted in different grounds. Wood summarizes his account of exploitation as follows: 'To exploit someone or something is to make use of him, her, or it for your own ends by playing on some weakness or vulnerability in the object of your exploitation.'[42] The taking advantage of someone's vulnerability to achieve our goal Wood calls 'a-exploitation'. This is the foundation of 'benefit' or 'b-exploitation' which is the use made. (So, in Wood's example, the charming spy a-exploits the government official's need for affection to b-exploit his official position to get access to a state secret.)[43]

What distinguishes morally wrongful exploitation for Wood, then, is taking advantage of the vulnerability of another to advance our own goals, and this is wrong because it violates proper respect for others. For Wood, 'Proper respect for others is violated when we treat their vulnerabilities as opportunities to advance our own interests or projects. It is degrading to have your weaknesses taken advantage of, and dishonourable to use the weaknesses of others for your ends. This moral belief, I submit, is widely shared, and it is why the term "exploitation" seems to us to refer to something bad, unfair, or unethical. This has nothing to do with the meaning of the word itself, but reflects a positive moral conviction which most of us hold.'[44]

Wood distinguishes 'innocent' exploitation from morally wrongful exploitation in two ways. First, the vulnerability has to 'count', it has to be significant enough. Secondly, taking advantage of another's vulnerability can be morally innocent when 'our use of another's vulnerability will not be degrading to the other (or if it is, it is deserved or at any rate morally acceptable.)' So we have no moral objection to 'innocent' exploitation – for example, chess players taking advantage of each other's weaknesses. One would not play the game unless one expected one's opponent to try to do that. As Wood puts it:

'One would not enter the game with good sportsmanship if one did not expect (or even want) one's opponent to use one's weaknesses whenever possible, and competitive play remains

[42] Wood's online definition at http://science.jrank.org/pages/21673/exploitation.html
[43] Op. cit. note 26 p. 15
[44] Op. cit. note 26 p. 15

morally innocent only as long as this sort of exploitation does not take a form which degrade the competitors'[45]

Wood, then, needs to show us what vulnerabilities 'count', if only some do, and what amounts to 'degradation' if that is a critical distinguishing factor.

Wood argues that B is vulnerable to A when in order for B to achieve some goal G, A is in a position to exercise influence over some (possibly other) aspect, or course of action of B. Wood rejects a similar, but simpler, definition of vulnerability – that vulnerability gives A some control over B – with the example of a servant pilfering from a master: he exploits his master's naïve trustingfulness, but has gained no control over him. The suggested definition avoids this problem; the master's goal is to be able to keep some money in his coat pocket without locking it in a safe every night; the servant's access to his clothes makes him vulnerable to the servant in that regard, without any overall change in the balance of control being required.

But Wood does not tell us what it is to degrade another. Is it feeling degraded, or being degraded that matters? At this point, we need a fuller account of degradation, but Wood does not supply this. We need it, however, for there are several relationships at play. A can treat B in a degrading manner; B may or may not feel degraded: and whether he does or not, B may or may not actually be degraded. What we are interested in is the last aspect: but this highlights that the principle that we must respect people and not degrade them does not of itself tell us what actions count as degradation. Is a high class prostitute/courtesan like Zola's Nana degraded by her profession when she exploits as much as she is exploited, if not more? Or consider the degradation relationships that run like poison through the veins of 'Wuthering Heights': Hindley degrades Heathcliff by treating him as a servant rather than a family member; Catherine disastrously believes that as a result marrying Heathcliff would degrade her; Heathcliff takes his revenge by degrading Hareton, Hindley's son through depriving him of education and so on. Some of these characters feel degraded when the reader might say that in fact they are not: others become actually degraded through their actions. Feeling degraded will reflect a person's psychological makeup, culture and the society and time he lives in.

[45] Op. cit. note 26 p. 16

Wood argues that exploitation is wrongful when it takes advantage of a vulnerability in an agent in a way that degrades that agent. So the chess players are not a case of wrongful exploitation, even though they take advantage of each other's vulnerabilities, because they do not degrade. But, aside from the difficulties noted above of knowing what it is to be degraded, I am not clear that this is the factor that picks out the wrongful cases of taking advantage of a vulnerability. It would seem possible to wrongfully take advantage of a vulnerability without degrading. Is the sweatshop worker *degraded* by working in a sweatshop? Relevantly for this thesis, when a borrower borrows from an MFI at an equivalent annual rate of 195%[46] to set up some small business, there will be many who feel that she must be wrongfully exploited, but without any suggestion that she is *degraded* by taking out the loan, setting up the business and attempting to repay it. The next chapter considers levels of interest rates in exploitation in microfinance in depth: the point here to establish is that if they are wrongfully exploitative, it is not because they *degrade* borrowers.

What we began searching for was the distinguishing factor that made some (at least person to person) exploitation (seen as taking advantage of a vulnerability) morally wrongful rather than innocent. Goodin argues that one person taking advantage of the vulnerability of another to him is always wrongful because of the duty of the strong to protect those vulnerable to them: if such a duty is not clearly established, however, a different principle to establish which, or all, vulnerability it is wrongful to exploit is required. Wood suggests degradation, but does not provide a full account of what it is to be degraded, or indeed the (presumably important) differences between feeling degraded and being degraded. I develop the idea that it is when a vulnerability arises from a low degree of autonomy (in a global or local sense) that it is wrongful to take advantage of it, below.

III. Autonomy and Exploitation

On my account, then, prima facie A wrongfully exploits B when A takes advantage of a vulnerability of B to A, benefit is derived from B, and B's vulnerability arises from either a low degree of autonomy in its global sense, or a low local autonomy in a particular situation. This account follows other vulnerability accounts of wrongful exploitation by requiring that

[46] see David Roodman 'Does Compartamos Charge 195% Interest?' David Roodman's Microfinance Open Book Blog, 31 January 2011. Available at http://blogs.cgdev.org/open_book/2011/01/compartamos-and-the-meaning-of-interest-rates.php

for A to wrongfully exploit B, A manipulate B in some way, is in a position of relative power with regard to B[47] and that a benefit arises from the interaction. A need not intend to benefit himself from the interaction to make it wrongfully exploitative – he may only intend to interact with B for B's own good – but if he does in fact derive a benefit from it, or if a third party of A's choosing derives a benefit from it, then, prima facie A wrongfully exploits. A pure benefactor, who neither intends nor receives benefit himself from his interaction, even when it involves taking advantage of a vulnerability of one with a low level of autonomy does not wrongfully exploit: but in practice he may need to take very great care that no benefit to him does in fact arise.

Not all taking advantage of vulnerabilities counts as prima facie wrongful exploitation. Whether it is wrongful to take advantage of a vulnerability depends on how that vulnerability relates to an agent's autonomy, either at a global or a local level.

(a) Taking Advantage of a Low Degree of Global Autonomy

At a global level, when the vulnerability arises from a low level of global autonomy, it is prima facie wrongful to take advantage of it, even if the exploiter did nothing to create the circumstances of the exploitee's low level of autonomy. It is prima facie wrongful, but could of course still conceivably be the best thing, overall, to do. What is a low enough level of global autonomy to count? The ability to act autonomously was defined in the previous chapter as having a minimum threshold of not only negative liberty, but sufficient positive liberties to access the basic goods of life: education, food, shelter, the means to make a living. A person has a low degree of global autonomy, then, when in the area being considered, he lacks, or only has a few of, the freedoms necessary to live a fulfilled life in this area.[48]

Whilst we can define a level of lowness of global autonomy for the taking advantage of it to count as prima facie wrongful exploitation, of course it remains the case, as argued earlier, that autonomy is something we hold to different degrees in different aspects of our lives. One is wrongfully exploited or one is not: one cannot be partially exploited. But perhaps the lower the degree of global autonomy, the worse the prima facie wrongfulness of the wrongful exploitation.

[47] At least with regard to the localised instance – A could in general have a lower level of power than B, even be employed by him for example, but be able to exploit him through a specific vulnerability of B to him, such as A's being a co-signature on B's cheques and stealing his money.
[48] This account is not a capability account, but in terms of capability theory the person with low global autonomy has a low number of the freedoms required to turn capabilities in to functionings.

The classic case of the taking advantage of a low degree of global autonomy is that of the sweatshop worker. The sweatshop worker has rational agency, and can voluntarily choose the low-paid sweatshop job as the only alternative to the even less remunerative subsidence farming: but that (let us suppose) is his only other option, and when the sweatshop owner takes advantage of this lack of ability to act autonomously and choose another job, to maximize his profit by paying the lowest possible wage, the sweatshop owner wrongfully exploits. As noted earlier, this is so even though the contract is mutually beneficial: indeed, the worker may derive more benefit from it than the sweatshop owner, to whom the marginal extra profit from this extra low paid worker may be very small, whereas to the worker the extra, however tiny, amount of income may be a matter of life and death.

When advantage is taken of a low level of global autonomy, the act can be prima facie wrongfully exploitative but still be the right thing to do anyway. Other factors can outweigh the prima facie wrongfulness of the exploitation. If the *only* terms on which the exploiter can mutually beneficially interact with the exploitee are prima facie wrongfully exploitative, but it is the right thing to do anyway, because the positive consequences outweigh the negative consequences – let us suppose here that the sweatshop worker would otherwise starve - then we would have a case of justified exploitation.[49]

How does the sweatshop owner here minimise the wrongfulness of his prima facie wrongful exploitation? To eliminate it completely, he would need to not take advantage of the low global level of autonomy of the worker. To specify this, we can imagine what salary the worker might receive in another factory if there were free movement of labour and he could migrate to work there. This would be the salary level the sweatshop owner should pay to avoid the charge of wrongful exploitation, for it would be the salary level that did not take advantage of the worker's low degree of global autonomy.[50]

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[49] It would be harsh to say that the sweatshop that operates at breakeven, but still pays below the level required not to take advantage of the worker's low level of autonomy, wrongfully exploits. It can, after all, do no more than operate at breakeven. In that case, if it really is deriving no benefit from the operation, the lack of benefit would meant that it does not wrongfully exploit. But benefit is not only defined in terms of profitability: all the benefits derived from the business by the owner would count, such as, for example, his own salary, or the status he receives from being the local factory owner.

[50] That rate would not quite be what unskilled labourers in factories in developed countries are paid in a world where movement of labour is heavily restricted. If there were free movement of labour, the price for unskilled labour in developed countries would presumably fall as supply increased and that would be the rate – higher than the sweatshop worker who cannot migrate receives, somewhat lower than unskilled labour in developed markets receives today – that would not be taking advantage of the sweatshop worker's low level of autonomy and would therefore not exploit him.

In the next chapter, when it comes to examining the practices of microcredit, this approach of looking at what it would take for an act or practice not to be prima facie wrongfully exploitative from the exploitee's point of view, in terms of what would *not* take advantage of his low level of global autonomy, rather than from the point of view of what the exploiter, what *he* can or cannot afford to do, is developed in the context of the interest rate that a borrower pays on a loan.

(b) Taking Advantage of a Low Degree of Local Autonomy

It is the taking advantage of a low degree of global autonomy that will have the most relevance when it comes to contemplating the practices of microcredit. Nonetheless, the relationship of a vulnerability of a generally highly autonomous agent to their local autonomy, to the particular circumstances of an individual case, can still help identify when taking advantage of those vulnerabilities is prima facie wrongful or not.

An agent can have a high degree of global autonomy, but a low degree of local autonomy with regard to a particular situation. This could be a low level of ability to exercise rational agency in a particular case, or a low level of ability to act autonomously in particular circumstances.

Pretty much any need or desire can make us vulnerable to others. But not all taking advantage of such vulnerabilities is wrongful. We distinguish those needs and desires over which the agent has no or low rational control, from those over which he has high control. Prima facie the drug dealer wrongfully exploits the drug addict, for the latter has lost the power to exercise rational agency over his desire for drugs, even if he had it once. Whims, desires and preferences over which the agent possesses rational control are not, prima facie, wrongfully exploited when taken advantage of. Taking advantage of vulnerabilities arising from mental health disorders, addictions, extremities of emotional pain where rational agency has ceased to be capable of being exercised, is.

An otherwise highly globally autonomous agent can also have a low level of ability to act autonomously in particular circumstances, and where that is so, taking advantage of the vulnerability in those circumstances would also count as wrongful exploitation. So the high powered legal trainee with a two year training contract with her firm, whose boss threatens to block her subsequent full-time appointment unless she sleeps with him has a high global autonomy, but a low level of local autonomy in these circumstances – she cannot leave the traineeship and is vulnerable to her boss's power over her appointment. This lack of options in these circumstances mean that she is wrongfully exploited. Similarly, the boatman who demands vast sums from Nozick's drowning millionaire[51] to save him wrongfully exploits the millionaire's vulnerability to him and lack of alternatives in the circumstances. And Wertheimer's[52] lecherous millionaire, who proposes to pay for expensive surgery the state will not provide to save B's child if B agrees to become his mistress, wrongfully exploits her lack of scope of autonomous action to circumvent her vulnerability in any other way. That these are exploitative rather than coercive is discussed in chapter 4; for here, what makes them wrongfully exploitative is the advantage the exploiter takes of the vulnerability that arises from a very limited scope for autonomous action for the exploitee in the particular circumstances that apply.

Exploitation is prima facie wrongful, then, when it takes advantage of a vulnerability of an agent, with benefit, usually but not necessarily accruing to the exploiter, and that vulnerability arises from either an agent's low degree of global autonomy, or a low degree of local autonomy in the particular circumstances that prevail. Taking advantage of a vulnerability arising from a low degree of autonomy, local or global, picks out which taking advantage of vulnerabilities are prima facie wrongfully exploitative, and which are not. Why we hold that taking advantage of a low degree of autonomy is wrongful could be accounted for by a number of different theories. Autonomy is dear to all of us, so to that extent common sense suggests it. A consequentialist may hold that autonomy is so instrumental to our achieving our preferences, or maximising our welfare, that the taking advantage of a vulnerability that arises from a lack of it is always highly likely to lead to worse outcomes. A Kantian might well hold that in order to treat others as ends in themselves, we do not take advantage of their vulnerabilities, the most especially when that vulnerability arises from a low degree of autonomy. Whichever normative justification of why it is wrongful to take advantage of a vulnerability arising from a low degree of local or global autonomy, this definition does seem to pick out when exploitation is prima facie wrongful. The next step is to apply that analysis to the practices of microcredit.

[51] Robert Nozick, 'Coercion' in Sidney Morgenbesser, Patrick Suppes and Morton White (eds.) *Philosophy, Science, and Method: Essays in Honor of Ernest Nagel* (1969) pp. 440-472 New York: St Martin's Press
[52] Wertheimer 'Exploitation in Clinical Research' in Jennifer Hawkins & Ezekiel Emmanuel (2008), *The Ethics of Clinical Research,* Princeton N.J.; Oxford: Princeton University Press, p65

Chapter 3: Exploitation in the practice of microcredit

The previous chapter concluded that exploitation is prima facie wrongful when it takes advantage of a vulnerability in an agent, with benefit derived from the exploitee, and that vulnerability arises from either an agent's low degree of global autonomy, or a low degree of local autonomy in the particular circumstances that prevail. This chapter will examine the extent to which this definition of wrongful exploitation applies to the offer and practices of microcredit.

As described earlier, microcredit is offering small amounts of credit to the poor, who are effectively excluded from the formal banking sector, at rates of interest which are typically substantially higher than those offered by formal banks but lower than those available from non-bank moneylenders. The borrower is vulnerable to the microcredit lender because of her lack of choice. If she is lucky she may have a choice between two equally high-charging microcredit firms, but she has no access to the lower rates in the formal sector. Her choice is also constrained in another way: living in rural poverty, she may have no options for raising herself from poverty other than borrowing capital to start a micro enterprise. There simply may not be an employment sector from which she can seek work. She is more than capable of autonomous choice from the point of view of meeting the minimum thresholds of rationality and self-consciousness for internal autonomy, but her global, external autonomy is constrained by a lack of options resulting from the poverty into which she is born. Microfinance borrowers are, typically, vulnerable in the sense of having a low global autonomy.

So which of the practices of microfinance might be thought to exploit her? Might even the very offer itself constitute wrongful exploitation?

The offer of microcredit makes use of – exploits in its neutral sense – the desire for credit. So too does the offer of a VISA card to the affluent in developed countries, where the desire for convenient forms of payment is also made use of. So far, so uninteresting: this is exploitation in its broadest, and not morally pejorative, sense.

For the offer of microcredit to be wrongfully exploitative, it must make use of a vulnerability that arises from a low degree of global autonomy (and benefit the provider.) Is the microcredit borrower's need for credit a vulnerability stemming from a low degree of autonomy, then, in a way my desire for a VISA card is not? It would seem so. I want a credit card for convenience; but if I cannot get one, I can save, I can use my regular account, I can draw on an overdraft – I have tools available to me that the microcredit borrower does not. The classic microcredit borrower lacks access to financial services that would enable day-to-day money management, the building of savings, ordinary loans or overdraft facilities. As Collins et al[53] put it, not having enough money is bad enough; not being able to manage whatever money you have is worse. Her lack of access to formal financial services makes her vulnerable to small, unexpected financial needs becoming large-scale disasters: and thus when she turns to microcredit, she is in a very poor negotiating position with regard to the terms and conditions on which she takes a loan.

Most MFIs would argue that their intervention is at least mutually beneficial, and therefore that there can be no (wrongful) exploitation. We have seen that a transaction being mutually beneficial does not prevent it from being prima facie wrongfully exploitative even if, overall, possibly still the right thing to do. What are the terms, then, on which microfinance could be offered, that would not be prima facie wrongfully exploitative? That just make use of the desire for credit (as with my VISA card), but do not take advantage of a vulnerability that arises from low global autonomy?

What makes the microcredit borrower vulnerable to the MFI and the moneylender where I am not vulnerable to the VISA card company, is the microcredit borrower's exclusion from formal financial services. Her exclusion is partly because of her lack of collateral, partly because the small unit size of her requirements make her too expensive on a unit cost basis for regular banks to serve, and partly because rural areas are much more expensive to service than urban. But excluded she is. The terms on which microcredit needs to be offered to her, then, that would not be prima facie wrongfully exploitative would be those offered to the financially included in her country: the cost of a regular bank account and savings account, an overdraft.

This chapter examines the terms on which microcredit is actually offered and whether it comes close to these levels. The level of interest rates at which microcredit is offered is considered first, and then other terms and conditions of the loan, notably group liability and compulsory savings. The bulk of this chapter is thus focused on whether the MFI wrongfully exploits borrowers in the rate charged for a loan, and other terms and conditions attached to

[53] Daryl Collins, Jonathan Morduch, Stuart Rutherford and Orlanda Ruthuen, *Portfolios of the Poor: How the World's Poor Live on $2 a Day* (2010),Princeton N.J.; Oxford: Princeton University Press p. 184

it; but the final section will consider whether there are parties other than the MFI who also wrongfully exploit borrowers, and indeed other parties than the borrowers themselves who are also exploited.

I. What Interest Rates Are

Setting out what interest rates are charged around the world ought to be straightforward: unfortunately, it is not. The rate that MFIs state that they lend to borrowers at are only seldom those which are actually charged. An MFI might state that it charges 5% per month for a twelve month loan, and tell donors that that equates to 60% per annum, but omit to mention that this is on a 'flat' rather than a 'declining' basis (so that although some of the capital is repaid each month, interest is still charged on the whole of the original sum lent, not the smaller amount that is left outstanding after each month's capital repayment). The effect of this is to push that 60% rate up to 111% on the average loan balance that the borrower actually receives, and that is before we consider whether we should be using compound interest here. These complications are more fully discussed in chapter 8. For the purposes of this chapter, in trying to look at what MFIs charge globally, rather than using what MFIs state they charge, rates as calculated by the Microfinance Information Exchange (MIX) are used.

MIX is a database of some 2100 MFIs accounting for 58m borrowers in 98 countries. Not all MFIs report to MIX, but it is a reasonable sample. It calculates a 'portfolio yield' for each MFI, which is used widely in the industry as representing the price of loans, and is the best proxy available for MFIs' interest rates. This is the actual interest and fee income received over a year by an MFI divided by its average outstanding loan book over the same period. This is indeed a much more accurate reflection of what is charged than the MFI's stated interest rates, but in some cases will still substantially understate. This is because a large number of MFIs only disburse eighty or ninety per cent of the stated loan size to borrowers, holding the remainder back as 'savings', effectively as collateral. Interest is charged on the whole sum however. This would mean that the apparent 60% loan above that would show up under the portfolio yield measure as 111% would in fact, if compulsory savings were 20%, be 245% on the average loan balance actually received. MIX does not make this adjustment however, because not all MFIs disclose that they make this deduction, hence their figures used below will understate what is charged to a possibly large degree.

It is also the case that portfolio yield will understate what actual borrowers pay because it nets off defaults: so that if a borrower has failed to make interest repayments, that will lower the portfolio yield. Those who have repaid, then, will have paid a higher rate than the portfolio yield shown.

MicroFinance Transparency is an organization dedicated to bringing some transparency in to microcredit interest rates. Using MIX Market data, it analyses interest rates charged by country on an Annual Percentage Rate (APR) basis, allowing for fees and any compulsory insurance, but not compulsory savings. A sample of interest rates charged in 2010 around the world is given below.

Table One: Examples of Microfinance Interest Rates for Small and Large Loans, 2010 (approx.)

	Small Loans			Larger Loans	
	Average Rate	*Range*		*Average Rate*	*Range*
Bolivia	36%	30-70%		20%	10-36%
Bosnia & Herzegovina	28%	10-54%		22%	8-31%
India	34%	20-46%		32%	22-40%
Kenya	40%	10-70%		32%	22-40%
Malawi	60%	16-133%		45%	10-120%

Source: MF Transparency, Live Country Data, 2010 accessed 2012.

How do these rates compare to other forms of credit? Using 2004 data and unfortunately excluding sub-Saharan Africa and Eastern Europe, but translating rates in to a common APR, Sandberg produces the following table:

Table Two: A Comparison of interest rates in developing countries[54]

Country	Commercial Bank Rates (APR)	Microfinance Institutions (APR)	Informal Sources e.g. moneylenders (APR)
Indonesia	18%	28-63%	120-720%
Cambodia	18%	~45%	120-180%
Nepal	11.5-18%	18-24%	60-120%
India	12-15%	20-40%	120%
Philippines	24-29%	60-80%	~120%
Bangladesh	10-13%	20-35%	180-240%

This bears out the common belief that microfinance rates sit between the rates in the formal sector of commercial banks, and wholly informal sources such as moneylenders. It should be borne in mind however that once compulsory savings are taken into account, in some regions microfinance rates will sit rather closer to those of moneylenders than between them and commercial banks.

We need to bear one further factor in mind when considering portfolio yields before considering whether these rates are wrongfully exploitative or not. This is that the rates normally quoted are averages. On 2006 data, Rosenberg et al[55] report that the average portfolio yield for sustainable (not subsidized) MFIs in MIX (weighted by gross loan portfolio) was 28.4%: but the range was from 15% at the fifth percentile (that is, the lowest portfolio yields) to 50% at the ninety-fifth (highest portfolio yields): and in Latin America it was 15% to 70%. The annualized rate of Compartamos, the Mexican MFI that had floated on Mexico's Stock Exchange that year, was over 85%, not including a 15% tax paid by clients.

Chuck Waterfield[56] of MF Transparency has tried to unpick some of the average portfolio yields by correlating the portfolio yield data to the average outstanding loans balances of the MFIs. He finds that those MFIs with the highest portfolio yields have the smallest average loan balances. In one example of 59 MFIs in the Philippines, the average rate of 33% hid a

[54] Joakim Sandberg, 'Mega-Interest on Microcredit: Are Lenders Exploiting the Poor?' (2012) *Journal of Applied Philosophy*, vol. 29 issue 3 p.170
[55] Richard Rosenberg, Adrian Gonzalez and Sushma Narain, 'The New Moneylenders: Are the Poor Being exploited by High Microcredit Interest Rates?' (2009) CGAP Occasional Paper no. 15
[56] Chuck Waterfield, 'Is Transparency Enough? What is Fair and Ethical When it comes to Prices in Microfinance?', Oct 11 2011, available at http://www.mftransparency.org/wp-content/uploads/2012/06/MFT-RPT-501-EN-Is-Transparency-Enough-What-is-Fair-and-Ethical-in-pricing.pdf

range of 14% to 72% with the highest rates applying to the smaller loan size. The same pattern is seen in Table One above, derived from MF Transparency's data, except in India, where there is much greater flatness. Given that loan size is widely taken as indicative of the poverty of a client (the poorer the client, the smaller loan size she can both make use of and be allowed by the MFI on risk grounds), it seems that the poorer a client, the higher the interest rate she is charged. We need to consider the wrongful exploitiveness or otherwise, then, not only of the rates paid on average by borrowers, but the fact that in the very wide ranging spread that makes up that average, it is the poorest who pay the most.

II. Why Interest Rates are Where They Are

Why, then, are interest rates, especially outside South Asia, so high, particularly for the poorest, when the industry aims at least on the face of it at poverty reduction? Despite outliers such as the for-profit Compartamos, where profit margin is an atypically large component of the interest rate charged, it is cost structures that determine the high and varying levels of interest rates that MFIs charge. The key, according to work carried out by Morduch et al[57] and quoting that of Gonzales,[58] is loan size. Clearly lenders need to reach a critical mass of clients, and Gonzales found that scale economies disappear after about 2,000 customers (others are higher.) After that, margins are increased by larger loan sizes and cross-selling other services (selling a borrower more than one service, which is hard for many microlenders who limit themselves to one product.) The larger loans made by banks, and additional products they cross-sell to clients, translate into lower costs per dollar lent for the bank as opposed to the MFI. The median bank spends 12c per $ lent on operating costs, the median NGO 26c.

This is so despite the average operating cost per borrower being $156 for the median NGO and $299 for the median bank. The NGOs keep costs down by spending less on staff, premises etc. – but it is not enough to compensate for the diseconomies of transacting small loans. Mordoch shows that it is operating costs, rather than capital costs or loan loss provisions, that drive the differences in total costs between different kinds of MFIs. Those MFIs that make the smallest loans on average (usually a sign of reaching the poorest) also

[57] Robert Cull, Asli Demirgu-Kent, Jonathan Mordoch, 'Microfinance Meets the Market' (2009) *Journal of Economic Perspectives* vol. 23 no. 1.
[58] Adrian Gonzalez, 'Efficiency Drivers of Microfinance Institutions (MFIs): The Case of Operating Costs', (2007) *Microbanking Bulletin* 15 pp. 34-42, Microfinance Information Exchange, Inc.

face the highest cost per unit lent. The institutions with the highest cost per unit also charge the most to their customers. MFIs charge more on small loans to the poorest, then, compared to somewhat larger loans to the not-so-poor, because their lending rate reflects the higher cost of making these very small loans.

An MFI's interest rate reflects four major components: its own costs of funds, its loan loss expenses, any profits it makes, and operating expenses.[59] Of these, operating expenses are the largest component: expressed as a percentage of the loan portfolio, they are 30% in sub-Saharan Africa,[60] 17% in South Asia[61] and 19% in Latin America and the Caribbean.[62] Operating expenses are personnel and administrative costs such as salaries, depreciation, transport for loan officers etc. Personnel costs vary widely. In sub-Saharan Africa they represent 14% of the loan portfolio;[63] in South Asia 6%[64] and in Latin America and the Caribbean 11%.[65] The number of borrowers each loan officer serves tend to be fairly constant (around 250): the difference comes in the salary of loan officers. In Sub-Saharan Africa the average salary of employees of MFIs expressed as a percentage of gross national income is 918%[66]; in South Asia 280%[67] and in Latin America and the Caribbean 270%.[68] The likely difference for the relatively expensive salaries in Africa is the lack of a large enough educated pool in the population from which to draw, leading to the salaries of those who have completed formal education being bid up. The percentage of the population educated to secondary school level for the three areas above is, respectively, 36%, 55% and 89%.[69]

Bar outliers such as Compartamos, profits are not the main driver of the level of interest rates. Rosenberg et al[70] have calculated that if the median MFI foreswore all profits, it would reduce the interest rate by only about one sixth. The profiteering of a few is not representative

[59] Operating expenses are all expenses related to operations i.e. personnel expense, depreciation, amortization and administration expense.
[60] Sub-Saharan Africa Microfinance Analysis and Benchmarking Report 2010, MixMarket, Microfinance Information Exchange, Inc.
[61] Asia Microfinance Analysis and Benchmark Report, 2009, MixMarket, Microfinance Information Exchange Inc.
[62] North America & Caribbean Benchmarks Table 2009, MixMarket, Microfinance Information Exchange, Inc.
[63] Op. cit. note 60
[64] Op. cit. note 61
[65] Op. cit. note 62
[66] Op. cit. note 60
[67] Op. cit. note 61
[68] Op. cit. note 62
[69] Gross enrolment ratio is the ratio of total enrolment, regardless of age, to the population of the age group that officially corresponds to the level of education shown (need more on this ref!)
[70] Op. cit. note 55

of the whole. This does not, of itself, determine the question of wrongful exploitation – to begin with, operations may be unnecessarily inefficient – but it is worth noting, as Rosenberg et al put it, ‘For the median MFI, the extreme and unrealistic scenario of complete elimination of all profit would cause its interest rate to drop by only about one sixth. Such an interest reduction would not be insignificant, but it would still leave microcredit rates at levels that might look abusive to politicians and the public, neither of whom usually understand the high costs that tiny lending inevitably entails.’[71]

Unfortunately, it is very hard to tell from the level of top-down statistics whether MFIs are reasonably efficient, or whether their operating expenses include avoidable ‘fat’. Operating costs are affected by loan size primarily, but also client location and density, transport infrastructure, salary levels, type of loan provided. We have seen that on average MFIs have to pay much higher relative amounts to employ loan officers in Africa than Asia; and they also face much higher transportation costs there, where the population density is 36 people per km^2 compared to 331 in South Asia and therefore for an African loan officer to service roughly the same number of clients as a South Asian loan officer, he really does need the expensive motorbike as opposed to a pedal bike to get around to client meetings.

MIX does categorise MFIs into various peer groups for rough comparison purposes, but, as Rosenberg et al again put it: ‘each peer group contains so wide a range of circumstances that one cannot confidently judge an MFI’s efficiency just by comparing its indicators with those of a peer group, let alone judge whether the peer group as a whole is reasonably efficient.’[72]

A very high administration expense ratio here could be reflective of the problems outlined in Morduch above, that reaching the very poorest goes hand in hand with small loan size and sometimes very high transport costs. But it could also be reflective of a bloated administration base. There are, after all, many different ways in which borrowers can be exploited: it could be for profit, but it could also be a comfortable job creation scheme for a not for profit NGO. It is hard to generalize here; the circumstances of an MFI would need to be examined individually.

To sum up the position of most MFIs and the rates they charge, then: typically, the average rate an MFI charges lies between rates in the formal banking sector and those of moneylenders. Rates are at their lowest in Asia, where high population densities and a large

[71] Op. cit. note 55, p. 21
[72] Op. cit. note 55, p. 13

pool of educated from which to draw loan officers keep operating costs down. Interest rates as stated by MixMarket, the best we have available, will understate what is truly charged, possibly by a considerable degree, because they exclude 'compulsory savings'. The average rates themselves do not on the face of it look too bad: but they hide a dispersion where the highest rates are very high indeed, and are being paid by the poorest clients. The main driver of these high rates, however, is not profit, but the cost of transacting in very small units – essentially because it costs as much to administer and monitor a \$50 loan as it does a \$500 loan.

III Are These Rates Wrongfully Exploitative?

On the account of exploitation that I am defending, microfinance borrowers are made vulnerable to MFIs by their low level of global autonomy, reflected in their limited options in terms of ways to earn a living, with borrowing capital to start a small business being one of the few ways open. When an MFI takes advantage of that vulnerability in a borrower's need for credit by charging a rate much higher than that which would be charged in the formal sector from which she is excluded, it prima facie wrongfully exploits her.

One important line of objection MFIs may make in response to this is that they do not exploit borrowers where their aims are wholly altruistic, for then they do not derive a benefit from the transaction, and in Chapter 2 it was noted that one of the necessary conditions for exploitation to be wrongful, was that a benefit had to be derived from the interaction with the exploitee. Clearly, commercialized, for-profit MFIs do extract a benefit in of the form of their profit, so this particular line of defence is not open to them. But what of not-for-profit MFIs?

The fact is that not-for-profit MFIs derive the same benefit from the borrower as the commercial MFIs: that is, the interest rate charged. Prima facie A wrongfully exploits B when A takes advantage of a vulnerability in B that reflects B's low level of local or global autonomy, and A benefits from the interchange. For commercial or not-for-profit MFIs, the advantage taken is the charging of an interest rate higher than it would be if the borrower's low global autonomy did not make her vulnerable to the MFI (i.e. than if she could get the 'urban' or possibly the 'formal' rate.) The benefit received is that interest payment. The commercial MFI then translates that interest payment in to a profit; the not-for-profit uses it as a contribution to its ongoing operations, and needs to top up this revenue stream from elsewhere to keep going: but it still benefits from it.

The not-for-profit MFI cannot make an offer of microfinance to borrowers if it has no staff at all. On the other hand, if it were giving local staff salaries and benefits that compared well with what they might earn elsewhere, and the head office staff are awarding themselves higher salaries and pension benefits on the basis of the number and geographical spread of the people in their employ, all paid for by the interest rate charged to the borrower, then we might be tempted to think that the MFI's employees are deriving at least some benefit from the interaction. Benefit can be derived from the terms and conditions of employment, especially where these go beyond what a similarly skilled employee might earn elsewhere, as well as through profits. The not-for-profit MFI exists, of course, to fulfil the charitable purpose laid out in its trust deed and it is the case that it is the employees who are deriving the benefit here, rather than the MFI as an institution. But the MFI's directors have a duty to ensure that they are fulfilling that trust deed, and not overseeing mission creep whereby the de facto focus of directors and staff has become using the interest payments received for the expansion and enhancement of numbers and terms for staff, rather than, for example, paying the bare minimum necessary and reducing the interest rate charged.

A difficulty for the not-for-profit MFI is that the source of its benefit, in terms of salary and employment, shifts over the life-cycle of the MFI if or when it grows. When the not-for-profit MFI starts up, its funding is usually provided by governments or aid agencies, private donation and founder capital. Before it starts charging interest to vulnerable borrowers, the bulk of the benefit of employment and salary is paid for by its donors/funders. In this start-up phase, the not-for-profit MFI is similar to a doctor working for the NHS in the UK. The ultimate point of interaction of both is with the vulnerable – poor borrowers, the sick – but at the point of service provision all that is being exploited by the doctor/MFI employee is the desire of the donors/NHS to provide a service to potentially vulnerable people. This is the innocent, neutral use of exploitation discussed earlier. It is possible that the MFI might wrongfully exploit here – if it took advantage of the donor's overenthusiasm to fund an MFI and ignorance as to what costs should be to set an expenses level far above what was necessary – but if it did, it would be wrongfully exploiting the donor, not the intended borrower, at this early, start-up point.

However, the position of the start-up not-for-profit MFI begins to change from the moment the not-for-profit MFI starts charging interest in excess of what we might call the 'non-vulnerable' rate to its vulnerable borrowers. At that point, some part (initially, a tiny part) of the benefit in employment derived from the offer of credit comes from the vulnerable people served. When the initial, external, source of funding has been used up, even the not-for-profit MFI becomes prima facie wrongfully exploitative.

The MFI's position contrasts to that of the UK government when in 1861 Gladstone, as Chancellor, set up the 'Post Office Savings Bank' to provide basic savings facilities to the then financially excluded working class poor of the UK. At a time when fifteen counties and a number of large towns had no savings banks and those that did exist were not open hours when the working classes could visit them,[73] Gladstone utilized the country's 2000-3000 Post Offices to reach the working classes with a simple savings account. The point is that the government paid the extra for these savings accounts to be provided to the working classes, not the savers themselves. If there was any 'fat' in the subsequent provision of these services, it was the Government that was exploited, not the working class.

The second way in which even a not-for-profit MFI might derive a benefit from its interaction with its borrowers may be more controversial: does its simple pursuit of its altruistic goal of helping the borrower alleviate his poverty count as such a benefit?

Here, the problem is that the relationship between an MFI and its borrowers is more complex than the relatively straightforward relationship between a benefactor and beneficiary. A charity which, for example, raises funds to pay school fees for girls from impoverished households stays in the benefactor/beneficiary relationship: there will be employment benefits to the benefactor charity here, but none of them are paid for by the beneficiary. The pure benefactor/beneficiary relationship may raise questions of paternalism, but does not raise any of exploitation.

The MFI aiming to use microfinance as a tool of poverty alleviation, however, aims to become sustainable (operationally profitable) in one district/region/country before expanding on into another. When an MFI becomes sustainable in an area, that does not mean that it has hit a point of perpetual breakeven; it means that it has now reached a degree of scale where its operations are no longer loss-making, but have turned profitable. It then has the option of

[73] Hansard HC Debate 08 February 1861, vol. 161 cols. 262-267

reducing its interest rates to stay at breakeven as further scale in its now operationally efficient area is added: or letting profits build up to fund expansion elsewhere. At this point, through its use of profits generated through the use of an interest rate in excess of the 'non-vulnerable' - formal - rate in Country A to fund expansion in Country B, the MFI is exploiting Country A borrowers to benefit Country B borrowers. Or, perhaps, it could be argued that the MFI is allowing itself to be the vehicle through which Country B borrowers exploit Country A borrowers. At any rate, the MFI cannot claim that it is not exploiting Country A borrowers because it is not taking advantage of them on the grounds that it derives no benefit from them. It does: the profits on its operations in Country A. It may then use that benefit for a third party, but that is not of relevance to Country A borrowers unless they have explicitly signed up to help Country B themselves.

With regard to exploitation, then, the not-for-profit MFI that aims to fund its geographic expansion through funnelling profits generated in one area in to the start-up costs of another (rather than, for example, reducing the level of interest in the profitable country) is to some extent in the same boat as the commercial MFI. A benefit to both MFIs is derived from the offer of microfinance, and although the assumption will be that that is going to be greater for the commercial MFI rather than the not-for-profit, it need not necessarily be so, if the commercial MFI is especially efficient in its operations and takes only a small profit, and the not-for-profit carries an especially fat expense base.

Does this mean that in practice it is almost impossible to offer microfinance ethically? No, it means that it is difficult to offer microfinance to very poor borrowers without, at least prima facie, wrongfully exploiting them. Offering credit may still be the right thing to do overall. Depending on whether microfinance actually satisfies its proponents' claims to raise borrowers out of poverty, it may indeed still be right, overall, to do.

On my definition of wrongful exploitation being the taking advantage of a vulnerability that reflects a low level of autonomy, the typical microcredit borrower is fairly clearly, prima facie wrongfully exploited, especially the poorest borrowers who end up paying rates far above the reported averages,[74] and much closer to (or even in excess of) moneylender rates

[74] Other accounts of exploitation might take the rate of interest charged and assume that because it is absolutely high, it is exploitative. The point of the financial analysis above is that it can break down how much the MFI must charge to lend and break even at all, and how much more that is than would be available from the formal sector, were the borrower not excluded from it. My definition of exploitation does not turn on the precise interest rate charged, which is an advantage because varying inflation rates in different countries would make putting an absolute number on this meaningless; but it does need this analysis to show the degree to which the

rather than those of the formal sector. What follows from this, however? Let us assume, for now, that despite the transaction being exploitative it is beneficial, all things considered, to the borrower. It is (in Wertheimer's terms) mutually beneficial and consensual. An examination of the actual empirical evidence that microcredit does succeed in alleviating poverty will have to wait for Chapter 8. But for the moment, I argue that, assuming that microcredit is, net, beneficial to the borrower, then extending it is the right course of action regardless, on the straightforwardly consequentialist grounds that it is so when the benefits outweigh the wrongfulness of taking advantage of a low level of autonomy. Hence the empirical evidence of later chapters, summarizing actual benefits and bringing together actual harms, will be key. How, though, might other accounts of exploitation treat microcredit?

IV How Other Accounts of Exploitation would treat Microfinance

How would other accounts of exploitation treat the relationship of the MFI and the borrower? I have split the descriptions of the various exploitation accounts that I have given into 'unfair usage' and 'vulnerability' accounts. In a recent article,[75] Snyder splits them into 'fairness' accounts and 'mere use' accounts, and then also splits the 'fairness' group into two sub-groups: (i) those who focus on micro fairness: 'those that do not include concerns about structural justice in the standard of fairness' and (ii) macro fairness: 'those that do incorporate concerns about structural justice when assessing fairness.'[76]

Wertheimer's account of exploitation is the classic micro fairness account: appeals to background justice or macro reasons why one party may be disadvantaged relative to the transacting partner (on my account, has a low degree of global autonomy) are strictly limited. What is fair is simply what a hypothetical fair market would produce: 'Taking advantage of another person in a pervasive way, as when structural injustice creates systemic, background

borrower is taken advantage of, and thus to measure if one MFI is truly worse than another, whatever the headline rate.

[75] Jeremy Snyder 'Exploitation and Sweatshop Labor: Perspectives and Issues', (2010) *Business Ethics Quarterly*, 20:2. I do not discuss what Snyder categorises as 'mere use' accounts here. These are accounts of exploitation as commoditisation: arguments that certain goods are of a nature that makes their trade morally repugnant or even incoherent, as Sandel argues of friendship. I prefer to call these arguments commoditisation debates, but the word exploitation is sometimes used to cover both these and 'taking advantage of' accounts. To the extent that these commoditisation debates are considered exploitation, this account does not attempt to cover them at all: my account might indeed also find that a father selling a kidney to pay for his son's education was wrongfully exploited, but it would be for coincident reasons, that his low level of global autonomy gave him no other way of raising the money, rather than because it was an intrinsic wrong to make use of his body in this way.

[76] Ibid. p. 189

disadvantage, will not count as exploitation on this view.' In the case of microfinance, if the transaction between borrower and lender is competitive (or hypothetically so, the high rate being what any microcredit lender would charge, given the high costs of delivery) and consensual, then the global constraints on the borrower are irrelevant and microfinance would not be deemed exploitative.

In his defence of sweatshops, Zwolinski[77] focuses on the importance of the concept of autonomy in the sense of making choices. He argues that if a choice displays even some exercise of autonomy, then there is a prima facie argument against interfering with it. The worker might prefer a wider choice of work, but once he has chosen a sweatshop as superior to the other, limited, alternatives, then to ignore his choice is to show him disrespect (on top of any disrespect shown him by the limitation of his choices in the first place.) Zwolinski maintains 'all else being equal, it is wrong to take away the option of sweatshop labor from workers who would otherwise engage in it.'[78] Since Zwolinski follows Wertheimer in using 'exploitation' in a moralized way, if no wrong is done in a consensual contract of labour, no exploitation can have taken place. Although he addresses sweatshops rather than microcredit, his position would likely to be the same (i.e. neither are exploitative). This is because he holds that there must be a rights violation for there to be exploitation, and as he holds that there is no right to a living wage, the sweatshop owner does not exploit the worker. I take it that establishing a right to credit at a reasonable price will be even harder than establishing the right to a living wage, and if Zwolinski rejects the latter, he would likely also reject the former, and therefore not find microcredit exploitative.

As Snyder summarises with regard to the microfairness approach to payday loans,[79] 'the microfairness standard of exploitation will have a hard time pinpointing any wrongdoing.' Sweatshops, payday lending and microcredit, even at rates as penal as those in payday lending, and for the poorest micro borrowers, are just not going to count as exploitative for

[77] Zwolinski, 'Sweatshops, Choice and Exploitation', (2007) *Business Ethics Quarterly* 17 (4): 689-727
[78] Ibid. p. 695
[79] Payday loans are an advance on a person's salary: in the US, they take the form of a short term loan issued in exchange for a post-dated cheque, typically dated for the borrower's next pay day. The interest rate for the few weeks the loan is given for can be 20%, on top of which fees are charged, which can give rise to an annualized interest rate (APR) of hundreds, even a thousand of per cent (see Faisal's presentation for UK also.)
These rates are (well) in excess of those charged by the formal banking system or credit system, just because these are loans to borrowers who fall outside the formal system (which may be because of past credit problems, or may be because of lack of comfort of the borrower with the culture of the formal system – in the UK a large number of borrowers using payday loans are minority immigrant communities such as Bangladeshis in East London (cite!) In the US African-American borrowers have been found to be disproportionately reliant on payday lenders for credit needs (Snyder quotes Stegman & Faris 'Payday Lending: A Business Model that Encourages Chronic Borrowing' (2003) *Economic Development Quarterly* 17 (1): 8-32

micro-fairness accounts, and so these accounts, in asserting the moral permissibility of them, have nothing to add about any conditions that then may attach going ahead.

There is a different outcome from what Snyder calls the 'macro-fairness' accounts of exploitation. This alternative standard for judging the fairness of a transaction attempts to allow for structural injustice. Sample, for example, (echoing Wood) bases her account[80] on taking advantage of vulnerabilities in ways that degrade people, and that includes a failure of respect someone by taking advantage of an injustice done to him: 'it is the action of taking advantage of the unfairness caused by injustice that constitutes a failure of respect.' Specifically, she argues of globalization that it 'exploits the degree to which background injustices experienced by vulnerable nations work to the advantage of their stronger interactors'.[81] Persons privileged through the process of globalization, she argues, can unfairly take advantage of the socioeconomic inequality and injustice brought on by trade liberalization.

As Snyder notes, it is not clear from Sample exactly what injustices create the opportunity for exploitation, or how one can avoid taking advantage of them. Mayer,[82] however, attempts to classify these by arguing that macro fairness exploitation can be tied to the failure of international institutions to protect human rights, including the right to a living wage. Thus he can argue that the price for regularly traded coffee is exploitative, but that for fair trade coffee is not. This is because he posits that everyone has the right to a living wage. Just looking at coffee trades from a micro perspective cannot find them exploitative on a fairness account, because they are mutually beneficial, consensual and competitive. But from a macro perspective, the just price is one an agent with a secure standard of living would accept. The 'fair trade' coffee price is fair because it is reached through a hypothetical bargain between persons that have a decent standard of living, or living wage. Snyder notes:[83] 'Both the micro and macro standard of fairness imagine a hypothetical exchange between parties in order to establish a baseline against which fairness can be measured. Only the macro standard, however, allows broad background factors like a right to a living wage to factor in to the calculation.'

[80] Ruth Sample, *Exploitation: What it is and Why It's Wrong*, (2003) Lenham, MD: Rowman and Littlefield
[81] Ibid. p165
[82] Robert Mayer 'Sweatshops, Exploitation and Moral Responsibility' (2007) *Journal of Social Philosophy* 38(4): p. 60
[83] Op. cit. note 75 p. 192

The macro fairness account might, then, find microcredit exploitative if it was held that either there is a right to credit at some reasonable level, or if there was perhaps something particularly racist or sexist in the exclusion of the poorest from the formal banking sector. Or for those who argue for a right to a living wage, then in areas of rural poverty where there is no salaried employment sector, a right to credit might exist where otherwise it would not, as the only way to facilitate making a living. These accounts, then, might hold microcredit exploitative and their remedy would presumably be to put the onus on the formal banking sector in countries where microcredit is prevalent, to extend its reach down and into the poorest communities.

It may be held an advantage of my account of exploitation that it does allow the taking into account of macro factors without the controversy of whether there is a right to a living wage or not. By linking the vulnerabilities that count to a low level of global autonomy, we can all agree that factors such as poverty, disability, remoteness, customs restricting free movement of women, reduce autonomy without having to argue that there are rights not to be poor, or to be compensated for disability. It is not that I do not, or might not, believe that the macro conditions that impair autonomy are not also unjust. That may well be so. But I do not want the account of exploitation I am offering to turn on a particular concept of justice and rights claims: rather, I want it to turn on a much more commonly accepted conception of autonomy.

Once we see wrongful exploitation as the taking advantage of a vulnerability that reflects a low degree of global autonomy (in the case of microfinance) then the remedy to it – even if it is somewhat hypothetical – becomes clearer. This is to stop trying to assess any absolute level of interest rates as too high, or a maximum level of expenses or profits for the financial provider – all of which look at what is or is not exploitative from the point of view of the exploiter – and look at the issues instead from the other end of the telescope, from the point of view of the exploited. What would be the rate of interest the borrower would pay if she, individually, were *not* vulnerable, if she was *not* excluded from mainstream financial services, whether that be by dint of gender, culture, distance or lack of formal collateral? What is the rate that would not exploit her by taking advantage of these vulnerabilities? This then becomes the rate – those of formal financial services in her country – at which she would not be wrongfully exploited, whether that be 10%, 20% or 50%.

Other attempts at trying to provide a sense of what is a 'fair' rate for a borrower to pay – the market rate, or costs plus a margin – fail to find a rate because they either fall foul of assuming that the market can set a normative rate at all, or they focus on what is fair, in the sense of affordable, to the MFI, some rate at which he can at least break even. This account instead looks at what is fair from the borrower's point of view by considering what conditions would not exploit her through taking advantage of her low degree of global autonomy. This is not the rate that she might *like* (we would all like to borrow as cheaply as possible), but the rate that does not take advantage of her vulnerability: which will roughly equate to the formal level of interest rates in her economy.

Identifying a rate that would not be wrongfully exploitative does not, of course, mean that many – or any – MFIs can provide it. We return to the point that, if the transaction is in the best interest of the borrower even at the higher non-formal rates, then wrongful exploitation can still be the right thing, overall, to do. Is, though, the rate of interest charged the only instance of prima facie wrongful exploitation in the practices of microcredit?

V Other Forms of Exploitation in the Practices of Microcredit

This chapter has focused on whether, and to what extent, the interest rate charged by MFIs to their borrowers is exploitative or not. It has been argued that it is the borrower's low level of global autonomy that makes her vulnerable to MFIs through her lack of choice of other means of making a living and lack of access to the better, lower, rates of the formal sector. The rate charged would not be exploitative if it did not take advantage of these vulnerabilities – if it were in this case, in line with the rates in the formal sector in the borrower's country. Whilst the interest rate has been the main point at issue in the discussion of exploitation in the literature, it is worth also briefly reviewing whether there are not also other terms and conditions attaching to the loan that taking advantage of the borrowers' vulnerability: that would not be applied if the borrower had access to the formal sector.

There are two principal such terms and conditions, explored in greater depth in later chapters, but notable as being (at the least) prima facie wrongfully exploitative here.

The first is the imposition of group liability on borrowers. This is the condition that loans are extended to borrowers in groups, and that if one in the group defaults on an interest payment or the capital, others in the group must make good the payment for her. Such a condition would be regarded as outrageous in the developed world, or for that matter in the formal sector of developing countries. In Chapter 5 we shall see that the practice of group liability goes beyond mere wrongful exploitation and can be seen to lead to coercion. But it is still worth noting that its imposition is wrongfully exploitative. Surveys of borrowers' attitudes[84] suggest that whilst they sometimes see merit in group lending, loans being extended to groups in villages who may provide support to each other, none have shown support for group liability, the guaranteeing of each others' loans. This is resented, but accepted as the only way to achieve access to the loan.

The imposition of group liability exploits, then, because the MFI takes advantage of the borrower's vulnerability, her need for credit and lack of alternatives in terms of either price or terms and conditions, to impose this unwanted condition, the benefit to the MFI being of course the greater security of repayment it now has.

A similar argument applies to enforced 'compulsory savings', discussed earlier, the use of which makes the interest rate very much less than transparent and leads to the borrower paying a very much higher rate of interest than she may be aware of. Again, the borrower has no choice but to accept this condition as a term of her loan, and her need for credit means she accepts it: but it exploits her. She is vulnerable to the MFI because of her need for credit and lack of choice; she is especially vulnerable to being charged more than she anticipates because the effects on the effective interest rate paid of compulsory savings are not spelt out to her and working them out without some financial literacy training and a calculator is far from easy, the benefit to the MFI of course being a higher effective interest rate achieved on the loan than the declared 'flat' rate. Neither group liability, nor compulsory savings are of course practiced in the formal sector.

VI. Is Anyone Else Exploited/Does Anyone Else Exploit?

As well as focusing on the interest rate charged by the microfinance institution to the borrower, this chapter has also focused solely on that MFI – borrower relationship. That is the primary relationship in which wrongful exploitation in the practice of microfinance can occur: but it is also necessary to give a wider context to this relationship, for there are two other sources of potential exploitation within the microfinance industry. One is whether MFIs exploit anyone else other than their borrowers in the practice of microfinance; the other is

[84] See, e.g. Malcolm Harper 'What's Wrong with Groups?' in eds. Thomas Dichter and Malcolm Harper *What's Wrong with Microfinance?* (2007) Rugby: Practical Action Publishing pp. 35-49

whether there are others, as well as the MFIs themselves, complicit in the exploitation of borrowers by the MFIs.

(a) Possible Exploitation of parties other than borrowers

One of the oft repeated claims of MFIs is that their clients use, or intend to use, the profits from their enterprises to send their children to school. There is no need to doubt the honest intent of that: but, as shall be seen throughout this thesis, the impact of microfinance can be very different from its practitioners' intent. In particular circumstances, it turns out that microfinance can lead to an increase in children being taken out of school, either to work in the microenterprise, or to substitute for the domestic labour of the female microentrepeneur.

The International Labour Organization (ILO) regards child labour as 'simply the single most important source of child exploitation in the world today.'[85] It reduces the child's current welfare and, through loss of schooling, future welfare. According to estimates by the ILO, there were 215m child labourers in 2008,[86] with the highest child labour force participation rates being in sub-Saharan Africa, even in countries where it is technically illegal.[87] The aim here is to examine the marginal impact of microfinance on the attendance of borrowers' children at school: it is not suggested that microfinance is a major cause of child labour itself. In countries where those under 14 are around half the total population (typically, where the adult population has been badly reduced by AIDs), child labour will inevitably be higher.

A number of impact studies have been conducted attempting to measure the effect of microfinance on schooling rates and child labour amongst borrowers' children. The strengths and weaknesses of such impact studies are discussed in Chapter 8. We can note here, however, that they are divided somewhat evenly between those that observed reduction in child labour, and those that found an increase.

According to the ILO, children are frequently taken out of school in order to boost family income when the family meets with an unexpected negative income shock, such as the male

[85] 'Child Labour: Targeting the Intolerable', 86th Session, International Labour Conference, Geneva: International Labour Office 1998

[86] 'Accelerating Action Against Child Labour, Global Report under the follow-up to the ILOP Declaration on Fundamental Principles and Rights at Work' (2010) ILO, Geneva.

[87] For example, in 2005 in Malawi, where laws prohibit child labour under the age of 14, there were 3.2m children working (Malawi Ministry of Economic Planning and Development) out of a total population of 13.5m, 6.1m of whom were aged 14 and under (US Census Bureau, International Database)

head of household becoming unemployed; 'child labour is used as a buffer against economic shocks.'[88] As the authors point out, however, unfortunately once a child is taken out of school and integrated into the labour market, they tend to stay there; transition back to school is difficult.

Microcredit can be an aid to solving this problem if a short term loan can cover the immediate shock without the child having to be taken out of school and a return can be made with the capital. It adds to the problem where the enterprise undertaken is a labour intensive one which is only just profitable, certainly not profitable enough to cover the cost of another full time employee: here, it may make most economic sense for the family to employ the child at no cost to increase productivity and thus profit. Further, if it is the microentrepeneur who is temporarily unable to work, the need to keep up the discipline of making the weekly repayment of interest may make taking the child out of school to keep the enterprise going the obvious first solution.

In some situations, microcredit leading to an increase in child labour is fairly predictable. Hazarika and Sarangi[89] found that access to credit raised borrowers' children's' propensity to work in rural Malawi during the peak harvest season. Essentially, in a country heavily dominated by subsidence farming, if a woman takes out a loan to run an enterprise, for much of the year she will juggle that and completing the household domestic work to keep the household going: but at harvest time she cannot do all three – help bring in the harvest (which will be the urgent priority), run the household and run the enterprise (where the weekly repayments will also demand priority). Children are then taken out of school to fulfil one of these functions in her place, usually that of domestic household work.

It can of course be argued here that it is the parents who exploit their children here, rather than the MFI. And indeed it is the parents who are taking advantage of their children's vulnerability to them and lack of autonomous power over the use of their own time. It is not, after all, as if the MFI is making the loan to the children. All this is true, but yet the role of the MFI in child labour is clear here, even if it is not technically the exploiter. It is the MFI's demand for consistent loan repayment when a family either endures a negative income shock, or needs to temporarily cease the micro activity whilst the harvest is brought in, that adds an

[88] Jonas Blume and Julika Bieyer 'Microfinance and Child Labour', (2011) Employment Working Paper no 89, ILO.
[89] Gautam Hazarika and Sudipta Sarangi, 'Household Access to Microcredit and Child Work in Rural Malawi' (2008) *World Development* vol. 36 issue 5 pp. 843-859.

extra incentive to take the borrower's child out of school to act as economic buffer. It is not argued here that the net impact of microcredit *overall* on borrowers' children's' school attendance is negative – that is not clear – but that, in the particular circumstances of negative economic shocks and harvest season in rural, subsistence farming economies, the impact of microcredit can predictably be to exacerbate an existing tendency for households to use child labour to solve the problem.

Whilst the MFI is not the exploiter here, it is complicit in the exploitation by the parents where it has been on the ground long enough to understand this mechanism, and makes the loans anyway. Loan officers are incentivised to have clients keep rolling over their loans, because that way the MFI derives the maximum number of interest payments from the borrower. If the MFI keeps pushing a client to roll over her loan during the harvest season when it knows that doing so increases the propensity of the borrower to take a child out of school to labour to support the repayment, then the MFI is at least somewhat complicit in the child's exploitation.

The MFI also, of course, has the most power to prevent that exploitation occurring. Allowing deferral of interest payments on a loan for a grace period whilst a client recovers from an economic shock,[90] or allowing the borrower to 'rest' – not take out a loan – during harvest season in rural, subsistence economies, without penalising her by lending a smaller amount or at a higher rate when she returns, would be steps MFIs could take to minimise the risk of credit pressurising parents into using their children as labour. Most straightforwardly, of course, they could decline to extend loans to borrowers who use child labour to conduct their enterprises with, or to let it be known that loans will not be renewed to those who decide to use child labour. Such a lending policy is very rare, however.

(b) Possible Exploitation of borrowers by parties other than the MFI

MFIs need to raise capital – be it donations, equity or loan capital – from somewhere, and care needs to be taken by those who provide it to examine whether they are themselves complicit in wrongful exploitation.

[90] As, in fairness, some MFIs do, notably Grameen Bank

The origin of financing for modern microfinance institutions was the type of funding classically available to NGOs – government subsidy, aid agencies, large foundations such as the Ford Foundation. The original funders of the expansion of Grameen Bank, for example, were the Ford Foundation, the UN International Fund for Agricultural Development and the governments of Bangladesh, the Netherlands, Norway and Sweden.[91] The aim may have been for the NGO to ultimately become self-supporting and not require further subsidy, but there was originally, in what has been called the 'Bangladesh model', little pressure for a return on the donors' capital as such.

This changed as microfinance became commercialized in the 90s and 00s. In the 1980s microfinance had become one of the international development community's programmes of choice in tackling poverty. It was seen as a considerable improvement as a way of achieving financial inclusion for the poor, certainly compared to what were seen as failure of government rural credit assistance schemes to reach low-income households. Most providers were not-for-profit and subsidized, and used a model similar to that of Grameen Bank. But the Grameen Bank model was not obviously sustainable. It had been promoted on the basis of its viability – with high repayment rates and low costs – but in the 1990s it transpired that repayments were being overstated and that it needed subsidies. Morduch noted: 'Grameen's repayment rates have never been as good as they claimed (but) because Grameen has been so well-known, nobody has wanted to risk undermining the reputation of the idea.'[92]

If this was true for Grameen, then it was true for most, for Grameen had much larger scale, density of population and lower unit costs relative to most providers. Although Grameen aimed to be sustainable in the long term, many microfinance NGOs in the 80s did not: they believed a constant subsidy drip was justified as the price of keeping the interest rates that they charged down.

In the 90s, the attitude of donors to constantly providing subsidies changed. The development community moved toward the view that whilst microfinance might be better than corrupt government agricultural subsidy, development subsidy to microfinance should not itself be indefinite. MFIs should aim, firstly, for breakeven ('sustainability'), and in due course straight commercial profitability began to be seen as acceptable. The goal was now large-

[91] Beatriz Armendáriz and Jonathan Morduch *The Economics of Microfinance* (2007) Cambridge. Mass.; London: MIT Press p. 12
[92] Quoted by Daniel Pearl and Michael Phillips in the article in WSJ, 27 Nov 01. The original Morduch article is: 'The role of subsidies in microfinance: evidence from the Grameen Bank' *Journal of Development Economics*, 60

scale outreach without the need for subsidization and if high salaries and bonuses were necessary to achieve that goal, that was acceptable. Some observers believed that this shift was disastrous. Bateman, for example,[93] argues that unethical profiteering, greed, irresponsible risk-taking, peculation and microfinance bubbles followed: that microfinance ceased to be about poverty reduction.

As microfinance moved in to the twenty-first century, commercial funding became available to microfinance: Leleux and Constantiou suggest some $30bn of it.[94] Microfinance's lack of correlation to other forms of investment and apparently safe returns made it an attractive portfolio diversification for investors. Capital flooded in from philanthropists, the international development community, private equity and venture capitalists. High points were reached with the stock market flotation of the most successful MFIs, notoriously Compartamos in 2007, whose prospectus demonstrated to the world that it was charging poor women borrowers rates sometimes in excess of 100%.

The question now becomes whether those investing in microfinance institutions with the aim of making a profit – or at least the 'double bottom line' of a socially responsible investment policy (of poverty reduction through microfinance) and a small profit – are complicit in any wrongful exploitation by MFIs that they invest in. This is the position of those such as Blue Orchard, Deutsche Bank, Citibank or Triple Jump, who run for-profit funds in this area, when they demand a return on their equity or loan investments in microfinance institutions. It would seem that the funds that channel capital to the MFIs to lend on to the poor cannot evade the charge of sharing in the wrongful exploitation of the poor if part of the MFI's motivation for charging high rates is to earn enough to pay interest on its loan from such a fund, or a dividend to an equity investor. As we have seen, there are limits on how efficient the making of tiny loans can be. Once an MFI is as efficient as it can be, barring technological developments, pressure for profitability means pressure to maximize the interest rate charged.

In examining wrongful exploitation in the practices of microcredit, then, those who need to examine carefully whether it is, even if prima facie wrongful exploitation, the right thing to

[93] Milford Bateman, *Why Doesn't Microfinance Work? The Destructive Rise of Neoliberalism* (2010) London: Zed Books

[94] Benoît Leleux and Dinos Constantiou, *From Microfinance to Small Business Finance: The Business Case for Private Capital Investments* (2007) Basingstoke: Palgrave Macmillan.

do anyway are not just the immediate providers, the MFIs, but those who make their activity possible as well.

Chapter 4: The Concept of Coercion

I have argued that microfinance is prima facie exploitative, though possibly the best thing to do anyway, depending on whether it *actually* meets is claims to sustainably raise women from poverty. But could the offer and practices of microfinance go beyond exploitation, and be coercive? This chapter aims to set out what we mean by coercion; the next chapter applies this definition to the offer and practices of microfinance.

There are two main strands of thinking on how we define coercion: moralised accounts and empirical accounts. Moralised accounts, of which the principle one is Alan Wertheimer's,[95] hold that the truth conditions of coercion claims rest on prior moral claims. We determine if Q has been coerced by P into doing act A by determining if P had a right to make his proposal to Q, and whether Q had any obligation to resist it. Empirical accounts of coercion – starting with Nozick's seminal 'Coercion' article[96] and developed by Frankfurt, Gorr, Feinberg and more recently Zimmerman and Anderson, hold that the truth conditions of coercion claims are empirical. If various conditions are met by P's proposal to Q, then it simply is coercive, although further questions then arise as to what coerced acts are then acceptable in a society.

Most empirical accounts of coercion are what Anderson calls 'pressure' accounts, which identify coercion with the way one agent can put pressure on the will of another agent by means of threats. The account I shall give will be an empirical account that does not deny the importance of the pressure that the agent feels, but requires an explicit identification of where force comes in to play as well: and that is in the forcing by the coercer of a limited number of options (classically, two) on the coercee, from which he must choose. The crux of coercion is thus the coercer impinging on the coercee's autonomy by establishing the set of options from which the coercee must choose, and preventing him from rejecting the entire set, rather than on the unattractiveness or otherwise of those options, as is more typical in pressure accounts.

This chapter, then, will proceed by looking first at Wertheimer's moralised account of coercion, and why empirical accounts are to be preferred; consider the major empirical accounts, and offer my interpretation of those; before in the following chapter applying this account to both the offer and practices of microfinance to examine if either or both should count as coercive and what should follow from that if so.

[95] Alan Wertheimer, *Coercion* (1987), Princeton: Princeton University Press
[96] Op. cit. note 51

I. Wertheimer's account of coercion

Wertheimer offers a 'two-pronged' account of what proposals are coercive. A proposal is coercive if:

(1) the proposal, if carried out, makes the recipient worse off that she had a right to be; and

(2) the recipient must be 'entitled to succumb' to the proposal.[97]

If the proposer has a right to make his proposal to the recipient, even if it is a threatening proposal, then it is not coercive: it is his right to make it, and the recipient's right to agree to it, that distinguishes coercion from other mere threats. 'If A has a right to make the proposal, he does not coerce B, even if the proposal puts B under great psychic pressure and even if B has no reasonable alternative but to agree.'[98]

Threats can coerce but offers never do. 'A makes a threat when B will be worse off in relation to some relevant baseline if B does not accept A's proposal, but…A makes an offer when B will be better off in relation to some relevant baseline position if B accepts A's proposal.'[99]

The key then is to determine B's baseline. This could be done empirically, or by using a moral test, and Wertheimer opts for the latter (hence, his account is a moralised one.) Comparing the classic gunman situation ('your money or your life') and an unemployed B choosing between a wonderful job and a merely good one, Wertheimer notes: 'Because the gunman A has no right to make his proposal, he proposes to make B worse off than B would be in the relevant baseline position, that is, B's situation prior to A's proposal. On the other hand, because employer A has a right to propose to give B a salary only if B agrees to work for A, A proposes to make B better off than B would be in the relevant baseline position, that is, where B is unemployed.'

The second prong of Wertheimer's account is that B must be entitled to succumb to A's proposal. If A makes a threatening proposal to B that fulfils the criteria above, but offers a

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[97] Op. cit. note 95 p. 307
[98] Wertheimer: 'Coercion' in Lawrence C Becker and Charlotte B Becker (eds.) *Encyclopedia of Ethics,* 2nd Ed (2001) New York & London: Routledge p. 246
[99] Ibid. p. 247

relatively trivial penalty unless B does a drastic act – for example A threatens to break B's arm unless B kills C – then if B does kill C, he was not coerced, 'because B should refuse to kill C, even at the risk of having his arm broken.' So a coercion claim requires two principles: (i) moral principles which allow us to set B's baseline so as to establish if A's proposal is coercive, and (ii) moral principles which will enable us to determine when B is entitled to succumb to A's coercive proposal.'[100]

Both prongs of Wertheimer's moralised account are open to objection. With regard to the first prong, the essence of coercion does not seem to be expressed by whether or not A has a right to threaten B, but by the fact that he is threatening him in the first place. Certainly, not all threats coerce: but what distinguishes coercion from ordinary threatening may be better found in further, empirical, facts, than in what rights A and B possess. Wertheimer's view commits him to finding a criminal gang's proposal to take away your car unless you pay over large sums of money coercive, but not the police impounding your car until you pay your road tax. Structurally, these are the same, with the latter simply being coercion which we regard as justified. Most of us are happy to think that we should pay our taxes, that taxes are justified, and yet allow that the collection of taxes is coercive (because we're threatened with jail if we don't pay them.) Presumably a moralised account of coercion has to say that the state is not coercive, as, for example, Edmundson does in 'Three Fallacies'. But it seems more realistic to acknowledge that of course that state, and the law, is coercive: perhaps paradigmatically. Nor does it just have to be the state that can exercise justified coercion. We might consider a parent preventing a child running across a road without waiting for the lights to change by issuing threats of the absence of tea, etc., as coercive, but justified: or a Clint Eastwood gunslinger who, happening upon the highwayman holding up a stage coach, demands he drop his weapon on penalty of death, as also being coercive, but not acting wrongfully as a moralised account would seem to require[101].

With regard to the second prong of Wertheimer's account, it seems extraordinary to say that B is not coerced by A when A threatens to break his arm unless he kills C. Rather, he surely was coerced, but the coercion was not sufficient to relieve him of all his moral responsibility for his act, and not sufficient to justify murder. Coercion may relieve an agent of some,

[100] Ibid. p. 248
[101] Wertheimer might reply that of course the parent has the right to do that: and the state to do that: and that Clint Eastwood to rescue the stage coach in those circumstances. He might, but that means his account of coercion requires a prior establishment of a theory of justice that explains everyone's rights, which seems a long way round to explaining coercion, and (as he recognises) could easily become circular.

sometimes all, responsibility for his act: but how much depends on the moral balance of the choice he had to make. A coerced choice remains voluntary: this apparent paradox will be developed below in the account I offer. But note for now that what is not voluntary in the highwayman case is not the choice of your money or your life, but being involuntarily forced to choose between those two options (and no others) at all.

As Arnold puts it:[102] 'To analyse coercion primarily in terms of rights and obligations (or other moral considerations such as utility maximization) does not adequately highlight the fact that coercion constrains individual freedom and undermines individual autonomy. For these reasons it is necessary to provide an empirical rather than a moralised account of coercion.'

Let us move on, then, to the empirical accounts of coercion.

II. An Empirical Account of Coercion

Empirical accounts of coercion, then, hold that we can determine if an act is coerced or not by looking at non-normative criteria. (Of course, normative criteria will re-enter the picture when we then decide, as a society, what coerced acts we want to allow. No society exists without any legal acts of coercion.) Nozick's account in his 1969 article 'Coercion'[103] set a framework within which subsequent empirical accounts have responded or adapted. To summarise his conclusions, P coerces Q into not doing act A if and only if:

1. P threatens to do something unpleasant to Q's interests if Q does A, and Q knows that this is a threat;

2. The threatened consequences make act A less attractive to Q;

3. P intends that Q not do A;

4. Q does not do A;

5. Part (at least) of Q's reason for not doing A is to avoid the consequences of P's threat;

[102] Denis Arnold, 'Coercion and Moral Responsibility' (2001*) American Philosophical Quarterly* vol. 38 no 1
[103] Op. cit. note 51

6. Q does in fact know and understand P’s threat (i.e. he does not mistake it for a ‘friendly warning’).

Note that this is a wholly empirical account. The facts about the structure of the proposal P makes Q determine if it is coercive or not. Moral questions may well still arise over the justification or otherwise of the coercion) and over the severity of the coercive threat, whether it was sufficient to absolve Q from some or all of his responsibility for his act. But the concept of whose rights are at stake is not raised in this account. By the time Nozick writes *Anarchy, State and Utopia*[104], this has changed, and a moralised account is given: there, when an agent has a choice between working or starving, his choice is only coerced if all the other individuals who have taken better jobs prior to this agent, did not act within their rights in doing so. If they all did act within their rights, then this agent’s choice was not coerced. This is open to the same objections as the moralised theories above: it is not that this may or may not be a correct description of whether the starving agent’s act is coerced or not, but rather that if it is, it is for coincident reasons. It is not the rights of others whom we may not even be able to track that determine if this agent is coerced or not, but facts about the limits on his freedom and autonomy.

But the 1969 ‘Coercion’ article is not moralised. When P moves Q from a ‘preproposal situation’, before the threat is made, to the proposal situation, to which Q must respond, it is only coercion if the above six conditions are met and Q’s pre-proposal situation was either the ‘normally expected’ or ‘morally required’ course of events. As Zimmerman points out,[105] this multiple baseline account is ultimately non-moralised, because when the ‘normally expected’ and ‘morally required’ baselines are different, Q’s own preferences resolve the tie. Thus whether Q’s compliance with P’s proposal is coerced or not comes down to which state he, Q, would rather be in (pre-proposal or proposal), which can be determined non-normatively: the need for ‘morally required’ evaporates.

Most accounts of coercion acknowledge the influence of Nozick’s structuring of the concept of coercion. One recent account, however, Scott Anderson’s,[106] criticises modern accounts – especially Wertheimer’s, but starting with Nozick – for placing too much emphasis on the psychological state of the coercee, to the extent that he suggests the existence of the coercer

[104] Robert Nozick *Anarchy State and Utopia* (1974) Oxford: Blackwell
[105] David Zimmerman ‘Taking Liberties: the Perils of ‘Moralizing’ Freedom and Coercion in Social Theory and Practice, (2002) Social Theory and Practice vol. 28 no. 4.
[106] In a series of articles, most particularly Scott Anderson ‘The Enforcement Approach to Coercion’, *Journal of Ethics and Social Philosophy* (2010) vol. 5 no. 1

almost drops out of the picture. He suggests that Nozick ends up treating the power implied by the coercer's threat – the basis of its credibility – as a kind of unanalysed given.

For Anderson, Nozick's account places too much reliance on whether the coercee finds the coercer's threat is credible or not, and that this obscures the broader power relations between coercer and coercee. This leads Anderson to distinguish two 'significantly different ways of theorizing about coercion.'[107]

The first way is what he calls the 'enforcement approach', which 'focuses on the ability of the coercer to inhibit actions by the coercee through techniques such as force, violence, and like powers, or threats based on such powers.' The other approach, the 'pressure approach', 'restricts coercion to cases where coercion manipulates the will of the coercee, though widens it to include any threat that puts pressure on the coercee's will and alters the coercee's intentional choice of action.'

It is true that in emphasizing what it is like to feel coerced, pressure accounts can have difficulty distinguishing what causes that feeling, which can be subjective to the coercee, and being coerced, of which the attempt is to give an objective empirical account. But it may be that Anderson goes too far in merging a coercion account into one of brute, physical force. The importance of the coercer in setting the conditions of coercion is indeed not to be underestimated: but a Nozick-esque account can perhaps be stated that gives that its proper emphasis, without having to lose important distinctions between compulsion and coercion. The latter two concepts are on slightly different parts of the spectrum of ways in which one agent can influence the acts of another: compulsion obliterates autonomy, coercion severely restricts the realm of autonomous choice to the coercer's choice set. The distinction seems worth preserving.

Nozick, for example, is right to deny that all infliction of violence constitutes coercion: rather, it is the future threat of it that does so. 'If a drunken group comes upon a stranger and beats him up or even kills him, this need not be coercion. For there need have been no implicit threat of further violence if the person doesn't comply with their wishes, and it would indeed be difficult for this to be the case if they just came upon him and killed him.'[108]

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[107] Scott Anderson 'How did there come to be two concepts of coercion?' (2008) *The Philosophical Foundations of Law and Justice* vol. 2 no 1
[108] Op. cit. note 51 p. 444

Arnold[109] distinguishes three types of activity that different accounts of coercion have sometimes included under that name:

1. Physical compulsion – brute force: manacling, kidnapping, imprisoning – these activities are what are, for Anderson, paradigmatically coercive;

2. Psychological compulsion – where the psychological state induced in the victim by the proposal is so extreme, he becomes incapable of rational choice at all, but wholly identifies with a desire to do what the coercer asks of him: e.g. the overwhelming fear of the knife at the neck, of being pushed from a building, Winston's fear of rats in his face in Room 101.

3. Rational compulsion – where, you deliberate the highwayman's proposal and decide, after more or less reflection, to prefer your life to your money.

Of course on some occasions these different types of coercion can run together. But it is worth distinguishing rational compulsion as what we mean by coercion, distinguishing it by the fact that whilst autonomy is impaired by the coercer, some autonomy, enough to make a critical choice, is left with the agent: and that is important when it comes to ascribing any quantity of moral responsibility to the agent for his act.

The account of coercion that I wish to present focuses on the third category above, rational compulsion, and would not count either of the first two as coercion, but as different forms of pure compulsion.

Force and coercion need to be distinguished from each other, for as Hayek notes, when one is coerced, one still acts. 'It is not that the coerced does not choose at all; if that were the case, we would not speak of his 'acting'…Although coerced, it is still I who decide which is the least evil in the circumstances.'[110] Compulsion offers the victim no choice at all. If I stop you from jumping in front of a train, I have forced you, not coerced you. Under force you have no alternatives to what those forcing you want: under coercion, you have alternatives, but the range of these has been fixed by the coercer.

Compulsion, then, removes autonomy altogether: one does not act at all, but is acted upon. Coercion infringes autonomy by presenting a forced choice amongst options the coercer has

[109] Op. cit. note 102
[110] Frederich Hayek *The Constitution of Liberty* (1960) London: Routledge and Kegan Paul p. 133

limited: but some autonomy remains to the victim of coercion that his choice between options is still a choice. With exploitation, as we have seen, it is a vulnerability that stems from a low degree of autonomy that the exploiter takes advantage of: in coercion, the coercer first impairs the autonomy by limiting choice to his chosen set of alternatives for the coercee to choose amongst; and then hopes to exploit the coercee's choice.

III. This Account of Coercion

At the centre of coercion is the constrained choice: an agent is obliged to make a decision from a set of alternatives that he has not chosen voluntarily. His autonomy has been limited by the setting of two or more alternatives on him by another agent, but he does still retain enough autonomy to then make a voluntary choice between those imposed options. The coerced act is both free and unfree: the decision whether to choose your money or your life is made freely and autonomously; the setting of an agent's options to being only his money or his life (not: both) is wholly involuntary. At the heart of coercion is what happens to an agent's freedom and autonomy. It is impaired through the limitation of choice to the coercer's set of options, but the choice between that set of options remains to be made.

If we accept this account of a coerced act as a forcibly constrained choice, we can see why in fact we do not absolve agents wholly from legal or moral responsibility for coerced acts. An act being coerced mitigates against an agent being responsible for it: it may mitigate entirely, but not necessarily, depending on the scale of the threat and the penalty offered, what the agent had to choose between.

The empirical account of coercion that I am putting forward is in the Nozick tradition, but emphasises the importance of the constrained choice that the coercee makes. The emphasis is less on the unattractiveness of the options that P presents to Q, but on the fact that P has forced this, and only this, set of options on to Q.

The account can be put in Nozickean terms as follows: -

P coerces Q where

1. P imposes on Q a choice of a or b (or a – n) and makes the pre ante status quo impossible: in particular, Q can no longer have a and b.

2. Each of the options made in the proposal to Q is significantly less attractive than his pre-proposal position.

3. P intends that Q choose one of the options he offers.

4. Q accepts one of the choices.

5. Q would not have chosen the course of action he does if he had not been obliged by P to make a choice between these particular options.

In (3), there is a case for saying, as Nozick does, that P intend that Q choose his, P's preferred option for Q: the highwayman wants Q's money, he is not imagined to be indifferent between being made rich by Q or killing him – he wants to be made rich. But whilst it would seem natural to say this, it would mean saying that if Q chooses P's non-preferred option, then he is not coerced. And that would be odd. The tortured rebellion leader who chooses a slow, painful death over revealing the secrets of his revolutionary friends' whereabouts has still been coerced. He is coerced by being forced to make the choice between painful death or betrayal, not by what he chooses.

Some will say that the rebel leader was subjected to coercive pressure, but since he did not choose the torturer's option, he was not ultimately coerced. I do accept that coercion is a 'success' word; the question is whether to measure success by P's obtaining the choice of Q's that he preferred, or whether to measure it by Q having to make one of the limited set of choices imposed on him (so failure here would be the rebel leader escaping and neither dying nor betraying his colleagues.)

If I hold that rebel leader is coerced here, even when he chooses death, then I will need to differentiate this type of case from seemingly trivial ones where P does impose a choice on Q, but a silly one. Imagine P threatens Q: 'Give me a million pounds or I'll cry 'Boo!'' to which Q replies, 'Well, cry 'Boo!' then!' Q has taken one of the alternatives offered to him, which would suggest that I would have to say that he is coerced here. The reason I need not hold that Q is coerced here is by appealing to clause (2) above. This requires that each and every of the options that P forces Q to choose amongst puts Q in a significantly worse position than he was pre-proposal. P crying 'Boo!' is not less significantly attractive than Q's pre-proposal situation of before P came along and annoyed him, because Q may be assumed to be pretty indifferent as to whether P goes around crying 'Boo!' or not. (If Q suffers from some sort of extraordinary Boo-phobia, perhaps this would be different.) To put it generally, trivial threats do not coerce because the trivial threat option does not significantly worsen the potential coercee from pre-proposal to proposal situation.

A different type of modestly threatening proposal that needs distinguishing from coercion is the simple one of such everyday practices as a shopkeeper raising his prices. The shopkeeper does indeed say ‘An increased price must be paid or you can’t buy from me’, but he can do nothing to stop the purchaser just rejecting his set of options and walking out of his shop. He does not coerce because whilst he offers the purchaser a limited set of options, he cannot prevent the purchaser from just rejecting the whole set. As O’Neill puts it, what marks out coercion is that there is no ‘no deal’ option available to the coercee. He has to take one of the alternatives. ‘The mark of coercion is the unrefusable ‘offer’, not the unrefusable ‘option’.[111]

The focus in this account of coercion, then, moves from the nastiness or otherwise of the options offered, to the enforcing of a constrained choice on an agent. Is imposing a constrained choice on someone prima facie wrong? Both Kantians and utilitarians will think so. As Zimmerman notes, for the utilitarian desire frustration per se is prima facie wrong, ‘so it is prima facie wrong for P to change Q’s situation in a way that makes it impossible for him to satisfy his desire to remain in the preproposal situation. The Kantian response is not so much that desire frustration per se makes coercion wrong, but ‘rather the failure to acknowledge the victim’s full status as a rational being…when one human being coerces another there is an aspect of the other’s rationality which he fails to acknowledge, namely the other’s capacity to set his own ends and to consider reasons for actions which go beyond the most immediate sanctions imposed in the threat situation. Instead, one who coerces uses the victim’s preference structure as a mere means for the attainment of his own ends.’[112]

The account given here, which allows for plurality of values but certainly puts autonomy high amongst them, would then find coercion prima facie wrongful as it always constrains an agent’s autonomy, but does not use the term in its moralised sense, as it is held quite possible that coercion can be justified (as with some state coercion) and thus coercion is not wrongful by definition. We need next then to look at the extent to which coercion is in fact practiced in microfinance, and whether those who use it within the microfinance industry are ever justified in doing so.

[111] Onora O’Neill, ‘What are the Offers *you* Can’t Refuse?’ in R.G. Frey & Christopher Morris (eds.), *Violence, Terrorism and Justice* (1991) Cambridge: Cambridge University Press, p. 182
[112] Matt Zimmerman, ‘Coercive Wage offers’ (1981) *Philosophy and Public Affairs* vol. 10 no. 2 p. 129-130

Chapter 5: Coercion in the Practice of Microcredit

Coercion could arise in the field of microcredit in two ways. The very offer of microcredit itself might be claimed to be coercive: and the practices used in the exercise of microcredit could involve coercion. Let us look at these in turn.

I. The offer of microfinance

The whole idea of there possibly being coercive offers may seem paradoxical, since an offer increases choice and if a genuine offer (rather than a concealed threat) can be refused. The standard example of an alleged coercive offer is Wertheimer's, of the lecherous millionaire. B's child will die unless her child receives expensive surgery that she cannot afford: A proposes to pay for it if, but only if, B will sleep with him.[113] The millionaire's proposal is clearly an offer: is it coercive? From B's point of view, the offer is just as coercive as the gunman's threat 'your money or your life': it is 'sleep with me or your child dies.' There is a similar example in Nozick[114] where a boatman come upon a drowning man and offers to rescue him from certain death if paid $10,000 upon reaching shore.

Zimmerman's[115] response to this is to label the lecherous millionaire not a coercer, but an exploiter. For him to coerce B, he must have deliberately created the situation in which B is helpless. He uses his island example to illustrate this: here, A kidnaps Q and brings Q to A's island, where A's factory is. A then offers Q work, which is Q's only alternative to starvation. Zimmerman regards this as a coercive offer. But if B, who also has a factory on the island, offers Q work first, even though Q's choice is still work or starve, then this offer is not coercive, because B did not bring about Q's predicament: he simply exploits it. The accounts I have given on coercion and exploitation would also treat B and the lecherous millionaire as exploiters rather than coercers. The crucial point is that neither has done anything to bring the situation about: they happen upon it, and take advantage. Of course, on Zimmerman island, if A then goes on holiday and Q begins to build a boat with which to escape, and B then smashes it up to ensure Q carries on working for him, then B would move from being an exploiter to a coercer, because it is now he who is enforcing the limited set of options on Q.

There is a sense though in which the lecherous millionaire and the boatman's offer to the drowning man do seem like coercion, and that is because they share an unusual feature. In

[113] Op. cit. note 95 p. 229
[114] Op. cit. note 51
[115] Op. cit. note 112 p. 129-130

regular coercion, the coercer sets about limiting the coercee's choices to the alternatives he, the coercer, sets. In each of these particular cases, before the intervention of the coercer/exploiter, the victim has no choices at all – the child will die, Nozick's swimmer will drown. The exploiter/coercer then comes along and, assessing the situation, creates a limited set choice with the pre-existing disaster situation as one of his limited set choices. He, as it were, takes over the pre-existing situation and shapes it into a constrained choice situation which looks just like a classic case of coercion, except that instead of forcing each of the alternatives himself, he incorporates the status quo in to his newly offered set. The key element I identified in Chapter 5 above in coercion is that the coercee must choose within the range offered: he cannot just walk away, the set cannot be refused.

Where the pre-existing situation that the exploiter/coercer incorporates is the coercee's death, it is hard to argue that he can in any sense walk away from the offer. The classically coerced agent has his ability to act severely constrained by the coercer. What distinguishes the cases we are considering here is that the agent has virtually no ability to act in the matter critical to him before the exploiter/coercer comes along anyway. He really does only have two options and although the coercer/exploiter has only brought one, not both, about, he has adopted them both as his own set.

If we think that a potential coercer can, as well as limit the coercee's options to the alternatives he brings about, also take a pre-existing situation and use it as his own in the offered set, then Nozick's drowning man is indeed coerced. The drowning man cannot reject the set of choices 'promise $10,000 or die' without fulfilling one of them i.e. drowning. Q on P's island cannot reject the set of choices: 'work in my factory or starve': he will starve.

Even if we allow, however, for the type of coercive offer exemplified by the drowning man and the starving kidnap victim on Zimmerman Island to exist, however, the offer of microfinance is not going to be such an offer. Certainly the situation of those in receipt of a microfinance offer is often desperate enough. But although the alternatives to microfinance are grim, they do exist. The offeree can return to subsistence farming. She can go instead to a moneylender or loan shark, even if at even more egregiously high rates. It would be rare that it really is a case of accept an offer of microfinance or die. When, then, the MFI takes advantage of the low degree of autonomy of the borrower to offer microcredit at interest rates well above those in the formal sector that the borrower is excluded from, the MFI exploits rather than coerces, because firstly the MFI did nothing to bring about the borrowers' low level of global autonomy; and secondly the borrower can reject the offer.

Outside of microfinance, though, it may not be entirely impossible to imagine an offer that could be called coercive as defined above. Those carrying out clinical trials in developing countries in order, for example, to find a cure for AIDS, will come up against a population with AIDS for whom participation in the trial may indeed be their only chance of escaping an early death. Here the trialist is acting like the demander of $10,000 for rescue from drowning. As O'Neill observes, to avoid becoming a coercer, one has to take into account the 'particular vulnerabilities and the actual limits of others' capacity to choose.'[116] Coercers and those wishing to avoid becoming one, have to figure out what is really unacceptable to the group they propose to interact with, engage with the potential coercee, and ensure the consequences of their offer either does or does not touch on that vulnerability according to whether they wish to coerce or not. 'Particularly in dealing with others who are weaker or dependant a lack of imagination or restraint may lead would-be no coercers to propose 'offers' that, despite their benign intentions, are actually unrefusable by those others.'[117]

Whilst the offeror of microfinance certainly needs to take that sort of care – after all, we have already determined that he is going to be exploiting, and that need not be much better than coercing – overall, it would be too strong to claim that the offer of microfinance itself was, typically, coercive. But that still leaves the question of some of the practices of microfinance within that offer, and I turn to that now.

II. The practice of microfinance

Many MFIs are joint liability: when a borrower takes a loan, she does so as part of a small group, and each borrower commits to repay the loan of any one borrower in her group who defaults on her loan. This has its roots in how microfinance groups were first set up by BRAC[118] and Grameen, with the borrowers' groups intended to be mutually supportive, helping each other out in difficult times: but once the group becomes responsible for individual borrowers' loans, the borrowing group have in one respect effectively become the

[116] Op. cit. note 111, p. 187
[117] Op. cit. note 111, p. 187-8
[118] BRAC originally stood for 'Bangladesh Rehabilitation Assistance Committee', but it is now used as a name, not an acronym as it has expanded in to urban as well as rural areas, and to other countries than Bangladesh. Microfinance is one of its major development tools, but it also offers health and education programmes.

MFI's loan collection officers, and given their own poverty and lack of ability to absorb any extra costs themselves, their loan collection practices can be severe.

Unsurprisingly, the type of practices that can very easily become coercive within microfinance revolve around debt collection. These practices are rarely discussed, but do emerge when periodic large scale repayment crisis hit. A survey of 130 borrowers in the Krishna district of Andhra Pradesh, long regarded as a mecca of microfinance and where today five of India's largest MFIs are headquartered, conducted after the repayment crisis there in 2006, found that allegedly coercive collection practices led borrowers to 'abscond', migrate out of the village, or even commit suicide.[119] The principal reasons for flight or even suicide given to the survey were: (i) joint liability (ii) compulsory attendance at meetings (iii) fines (iv) keeping all members waiting until repayments are made.

Crisis in Andhra Pradesh re-emerged in 2010,[120] where the extension of microcredit had exploded from 40 billion rupees to 8 million borrowers in 2007 to 225 billion rupees to 25 million borrowers in 2010. This expansion was fuelled firstly by a government programme to provide cheaper finance to borrowers and secondly by commercial MFI expansion, which in its rush led to a loss of credit discipline from lenders and clients talking on multiple loans and becoming overindebted. Fresh reports of suicides amongst those unable to service all the debt prompted Andhra Pradesh's chief minister to pass an Ordinance imposing new conditions on loan collection (less frequently and from locations near to local government premises) which prompted a collapse in loan repayments and threatened the future viability of some MFIs. One set of authors and industry practitioners, observing that the 2010 crisis was on a different scale from previous crisis, concluded rather comprehensively: 'The causes were complex and involved MFI management's pressure for growth at all costs, promoters' and investors' greed, bankers' folly, clients' overborrowing, journalists' frenzy, bureaucrats' inertia and politicians' irresponsibility.'[121]

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[119] Prabhu Ghata 'Learning from the Andhra Pradesh Crisis', in Thomas Dichter and Malcolm Harper (eds.) *What's Wrong with Microfinance?* (2007) Rugby: Practical Action Publishing p. 169. Note thought that whilst suicides certainly occurred, there is no concrete evidence that suicides amongst microfinance borrowers were any higher than the 14 per 100,000 in the population as a whole.

[120] See Abhijit Bannerjee, Pranab Bardhanm Esther Duflo, Erica Field, Dean Karlan, Asim Khwaja, Dilip Mookherjee, Rohini Pande, Raghuram Rajan, 'Help Microfinance, Don't Kill It' (2010) The Indian Express, November 26 2010, online at http://www.indianexpress.com/story-print/716105, or 'Andhra Pradesh 2010: Global Implications of the Crisis in Indian Microfinance.' (2010) CGAP Focus Note 67, Washington, D.C.

[121] Malcolm Harper, Lalitha Iyer, Jane Rosser, *Whose Sustainability Counts? BASIX's Long March from Microfinance to Livelihoods* (2011) Sterling VA: Kumarian Press p. 37-8

There is at least a case, then, for considering whether some of the practices by which microfinance is carried out – in particular, the group liability model – are coercive. This latest crisis in Indian microfinance prompted one rural practitioner, Ramesh Arunachalam, to begin blogging on what clients are reporting to him in Andhra Pradesh, Tamil Nadu, Kamataka, Orissa, and West Bengal. Arunachalam reports the following strategies as being used by some (not all) MFIs to achieve loan repayment when clients are struggling:

> Strategy # 1 - Life/Work Obstruction: Field workers, agents, centre leaders and/or group leaders may hinder and obstruct the normal life and work of clients and/or their families and thereby, force them to repay, using several means (borrowing from money lenders, take over assets etc.) that may not necessarily be in the clients' interest and one which could cause undue hardship to them
>
> Strategy # 2 – Threats: Collection agents/field workers could threaten the clients that they would resort to violence and/or physical abuse if money is not repaid; they may also carry the threat out, if money is not forthcoming from clients;
>
> Strategy # 3 – Verbal Abuse: Field workers/agents may (verbally) insult, abuse and/or intimidate the borrowers and their family members and get the repayment
>
> Strategy # 4 – Following the Client and Pestering: Field workers/agents could continually follow the borrowers and their family members from place to place and pester them for repayment and keep on embarrassing them, until the money is paid;
>
> Strategy # 5 – Repossession and Sale of Property: Sometimes, the centre leaders and/or group leaders/other members may even take over property owned or used by clients and sell that and take the repayment
>
> Strategy # 6 – Satyagraha Outside Client's House/Place of Work: Field workers/collection agents could sit outside the house or places of work (like fields/shops) for hours and hours and keep on harassing for payment and leave only after they get it
>
> Strategy # 7 – Embarrassment Strategy: Field workers/collection agents may sometimes even talk to business customers and/or guests of the clients and embarrass clients and thereby get them to repay
>
> Strategy # 8 – Physically Take Over Assets/Documentation as Collateral: The centre leaders, group leaders and/or members could forcibly remove assets/documents of the borrower (like ration card etc..) and not return it until repayment is made by the client
>
> Strategy # 9 – Physical Intimidation: Field workers/collection agents may physically intimidate the clients and get local toughs to rough them up once or twice, so that repayment is forthcoming thereafter. [122]

Part of what is striking in Arunachalam's depiction of loan collection practices is that it is not just the loan officer of the MFI owed the repayment who is involved. In many cases MFIs are hiring third party agents to do their collection for them: although this is just an extension of the MFI, it is hardly unheard of for third parties to be less scrupulous than the original lender in collecting loans, as they do not have a 'brand' to defend in the lending marketplace. Alongside the agents, however, are the group members themselves, collecting on behalf of

[122] http://microfinance-in-india.blogspot.co.uk/search/label/Coercive%20Repayment

the MFI in order to avoid having their own savings confiscated. These instances in Andhra Pradesh are not isolated. Extreme coercion was reported back in the late 90s; one of BRAC's own research studies, quoted by Richard Montgomery[123] reports a conversation with BRAC women in which 'they told…with pride that they had pulled down a member's house because she did not pay back her housing loan.'[124] Montgomery suggests that such violent action may not be common, but 'examples of "forced" acquisition of household utensils, small livestock, or other assets of defaulting members were mentioned.'

Lamia Karim, an assistant professor of cultural anthropology at the University of Oregon-Eugene who spent eighteen months studying the microfinance industry in Bangladesh, argues that the fusion of the collective responsibility for loan repayments, and the cultural norms of kin obligations in Bangladesh 'are toxically synergistic, and coupled together they work to operate within an economy of shame'.[125] She adds: 'In analyzing the reasons why rural men allowed their women to become NGO members even though it brought their women in contact with non-kin men, one noticed a deep level of complicity between NGOs and rural men. Despite rural codes of honor/shame that dictated that women should not come in contact with non-kin men (and most NGOs, especially Grameen Bank, have male officers), rural men found it useful to allow their women to join NGOs because they (rural men) work during the day. Poor men who lack physical collateral 'give' their women in membership to NGOs as economic reassurance. In reality, *the collateral that Grameen women and all other NGOs extract from the poor is the Bangladeshi rural woman's honor and shame*. The poor give their honor embodied in their women to the NGOs in exchange for loans.'[126]

Yet even the issue of shame is complicated – it does not always result in the infliction of violence on women by men, though Rahmen records this.[127] The husband may also feel intense shame if his wife is humiliated in such ways and he is not able to protect her. After the 2010 Andhra Pradesh crisis, press reports focused on the reported suicides of women borrowers, which were certainly tragic enough, but there were also male suicides. Indeed, a

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[123] Richard Montgomery 'Disciplining or Protecting the Poor? Avoiding the Social Costs of Peer Pressure in Micro-Credit Schemes', (1996) *Journal of International Development*, vol. 8, no. 2, pp. 289-305

[124] The report cited was Ken & Stewart, 'Institution Building and Development in Three Women's Village Organisations: Participation, Ownership and Autonomy.' Dhaka: BRAC Research and Evaluation Division, unpublished paper.

[125] Lamia Karim 'Demystifying Micro-Credit; The Grameen Bank, NGOs, and Neoliberalism in Bangladesh', (2008) *Cultural Dynamics* 20 (1): 5-29, p.15

[126] Ibid. p16, emphasis in original

[127] Aminur Rahman *Women and Credit in Rural Bangladesh: Anthropological Study of Rhetoric and Practices of Grameen Bank Lending* (1999) Boulder, Colorado: Westview Press, esp. pp. 120-124

recent report finds that whilst a rise in all suicides seems to accompany microfinance growth and penetration, this is especially so of male suicides.[128]

During her research, Karim observed routine credit related strife amongst members and their families. This ranged from scolding, removing a woman's gold nose-ring (a symbol of marital status, symbolically divorcing/widowing her), and taking a woman's family's food supply, leaving them with none. NGO officers did not participate, but oversaw, and threatened to withhold future loans unless the defaulted money was recovered. In the worst cases, where the default was large enough that everything already was repossessed, members

> would sell off the defaulting member's house. This is known as house-breaking (*ghar bhanga*) and has a long history in rural society. It is considered the ultimate shame of dishonour in rural society. In other words, serious defaults led to homelessness of the families concerned. In my research area, house-breaking occurred several (six to seven) times, whereas smaller forms of public shaming occurred every week. There were several instances of suicide committed by men who had been shamed by their inability to protect the honor of their families. But those instances were rare, and were often the result of multiple causes, such as flooding in low-lying areas. What is important to note though is how the pre-existing coercive norms, of house-breaking for example, have become institutionalized as part of the NGO technologies of loan recovery.[129]

Karim reports that the NGOs also use the apparatus of the state, the police, to have defaulting women arrested until a loan is repaid. She met a number of women who had then been divorced by their husbands because they had 'disgraced' their family by going to jail.[130] She reports the NGOs as fully aware of the consequences on borrowers of their, or the fellow borrowers', efforts to achieve loan repayment. But the perception is strong amongst MFIs that default rates would be higher on individual loans than group loans, and certainly the costs of collection would be very much higher for the MFI, since the lending group are essentially acting as its loan collection officers, unpaid.

Lastly, in her tale of Jahanara Begum, Karim describes a practice on the ground of microfinance about as far removed from every public image of the practice as it is possible to get. Jahanara is a very successful microfinance client. She borrows from multiple MFIs, and uses the money to lend on at higher interest rates; she runs a very successful classic

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[128] Arvind Ashta, Saleh Khan, Philipp Otto 'Does Microfinance Cause or Reduce Suicides? Policy Recommendations for Reducing Borrower Stress (March 3, 2011). Available at SSRN: http://ssrn.com/abstract=1715442 or http://dx.doi.org/10.2139/ssrn.1715442

[129] Op. cit. note 125, p. 19

[130] David Hulme reported a similar instance in 1997. For a woman to leave home without familial male company breaks the rules of purdah, and where she is arrested for failure to repay debt (not that the police are entitled to do so on an uncollateralised debt) and held overnight at the police station, she faces divorce on her return home. These issues are rarely reported: the case Hulme reports on came to light only because a police vehicle carrying such debtors crashed and all were killed. Quoted in 'Is Microdebt Good for Poor People?' (2007) in eds. Thomas Dichter and Malcolm Harper *What's Wrong with Microfinance?* Rugby: Practical Action Publishing, p. 20

moneylending business, funded by Grameen and other NGOs. Karim accompanied her as she went in pursuit of a fellow Grameen borrower who was behind on her repayments.

> On the way to Kashai Bou's house, Jahanara proudly told us that she had broken many houses when members could not pay. "We know when they cannot pay, so we take a carpenter with us to break the house." I asked Jahanara, "Why do you break the houses of kin?"
>
> Jahanara became indignant at first. Her comment was "Why should we not? They have breached their trust with us. If they cannot pay, then we will have to pay. Why should I pay for them?" Then she became quiet and said after a while added, "It is not good to break someone's house, but we are forced to do it. This is how we get loans from Grameen Bank and other NGOs. They put pressure on us to recover the money, then we all get together and force the defaulting member to give us money. " [131]

I have not argued that the offer of microfinance is coercive. But the effect of making group liability a condition of that offer would seem to foreseeably create the circumstances where coercion is used for loan collection in practice. At the heart of the practices described from the field, it is the basic, central plank of microfinance, the group liability model itself, that creates the pressure that results in coercive loan practices being used. It is a requirement of a borrower taking a loan, that she guarantee the repayment of the others in her lending group as well. There is no choice in this: it is a condition of taking out the loan. Her position is already one of poverty: when a fellow borrower does get into trouble, then, her ability to cover that debt may be limited and she may very well resent the sacrifice it will impose on her. Furthermore, it is reasonably standard practice of MFIs that fresh loans are not extended to a group when they are due to rollover, until all in the group have repaid. This means that for those borrowers for whom the microcredit is the lifeline that keeps them and their business going, the MFI threatens to cut that off unless they either cover the repayment of the defaulting borrower, or find a way to force her to repay it. Their behaviour, as chronicled above, can then indeed become fiercely coercive. This is a far cry from the idea of 'self-help' that the group lending model is supposed to generate in the microfinance literature.

Stepping back, then, there are a number of relationships in the practice of microcredit that can become coercive. Are any of them instances of justified coercion?

The coercion of the borrower by the loan officer, his agent, the group itself or the group's leader, where these parties variously harass, threaten and even break the house of the borrower, is not justified coercion. The borrower has not given collateral on the loan, she has

[131] Lamia Karim *Microfinance and Its Discontents: Women in Debt in Bangladesh* (2011) Minneapolis, Minn.: University of Minnesota Press pp. 110-11

not agreed in advance to these sanctions: they are an ugly side of microcredit, and are not justified.

When the MFI coerces the group of borrowers, however, threatening to dip in to their savings that it holds to make good the default on an interest payment by one member of the group, it is justified in doing so. This is the *only* sanction that has been consented to in advance, and the MFI is entitled to use it.

In practice, MFIs often prefer not to, at least at first, but rather to threaten to withhold new loans to the group unless they ensure the repayment of the defaulting borrower. This is preferred because otherwise the MFIs stand to lose the good business of the rest of the group going forward. But this is *not* a sanction that has been agreed to in advance by the group – it is not a part of the terms and conditions of *their* loan that future loans to them are dependent on the repayment by others in the group. This form of coercion, then, is *not* justified.

There has to be one major caveat to even the one form of coercion that can be seen as justified, the MFI withholding the savings of group members to cover the default of one. The examples above show that though this coercion may be justified, it can lead to the group itself, driven by its own relative desperation, issuing and enforcing cruelly coercive threats to the defaulting member, or indeed using straight compulsion to steal her remaining assets in compensation for the payments made for her.

It could be argued that if a woman knows that those are the conditions of the loan, and has perhaps heard about the poor experience of others, then she is deemed to have given valid consent to the coercive practices that then follow. One can voluntarily give consent to future coercion or compulsion and thereby legitimate it, as one would if one consented to, for example, being hypnotized as a way of giving up smoking. Perhaps as Mill argued it is not possible to sell oneself in to slavery, but the contract imagined here is nothing like as extreme as that.

Perhaps this line of thinking is a mistake however. The borrower consents to the offer of microfinance and the group liability model that comes with it. But even though she may know that group liability often or sometimes results in fellow borrowers imposing coercion and compulsion on their defaulting sisters, that knowledge does not mean that she consents to the use of that coercion. The coercion itself remains illegitimate: the loan is, after all, not collateralized. The fellow borrowers have a contractual agreement to repay her loan for her if she cannot (and vice versa): the fact that some then use extreme methods to try to escape that liability does not legitimize their doing so, and how common or otherwise that is does not carry with it the signing up borrower's consent to the practice.

The MFI cannot stand back and claim that it does not carry out coercive loan collection practices itself, that only the women borrowers (unfortunately, sometimes) do. For the women only act to recover back some of their costs in covering the defaulter's debt because the MFI would refuse to extend their future loans if they did not cover this debt. When the MFI has insisted upon the use of group liability, and knows from experience that as a result practices such as house breaking occur, it cannot claim to be innocent of them when they do. It bears the indirect responsibility for actions that are, in legal terms, the 'reasonably foreseeable' result of its threat to the borrowing group.

III. Conclusion

What shall we conclude, then, of the relationship between microfinance and coercion?

The offer of microfinance, itself, is not coercive. In general, where one agent takes advantage of the extremely difficult circumstances, of the low level of global autonomy of another to make an offer on terms that would not be accepted in happier circumstances, they exploit rather than coerce. Perhaps there can be even more extreme circumstances where the exploited or coerced agent actually has no options at all – she is facing death, already – and by adding one other option to that situation, the exploiter/coercer does coerce, because he has made an offer of a set of choices where the set itself cannot be rejected. The offer does increase the choice available, and so is an offer, but is made by including within it in a set of offers which as a whole, cannot be rejected, which is coercive. The offer of microfinance, however, does not fall within this definition of a coercive offer, because the set (loan on these terms, or no loan) can be rejected – there are other life options available, and even other finance offers, however unattractive.

But the central plank of the offer of microfinance, the group liability model, which is a condition of taking the loan, does lead to coercive loan collection practices in at least some cases. As Karim puts it, this is not incidental to microfinance, but (at least in Bangladesh) central to it – it is an 'economy of shame' where the culturally crucial notion of shame is used to replace the collateral women do not have to take out loans.

It has been shown that coercion is not, in most instances, justified by the prior consent of the borrower to the sanction: where the coercion is from the MFI to the group, expropriating their savings to make good a default, it can be, but all the other forms – coercion of MFI/agent/group against the borrower is not so justified by consent.

Can it be justified by the consequences of the use of microcredit being so beneficial, in raising borrowers out of poverty, that a bit of coercion along the way is offset? Given the extent of some of these coercive practices, that seems unlikely: and it seems even more unlikely that even if the consequences were positive overall, that they were, individually, for the borrower who has had her house broken and is now homeless. But these issues will be discussed in full in the final three chapters.

What is going unchallenged here is to what extent the group liability model is truly essential to the offer of microfinance. Practitioners certainly typically assume that without group liability, defaults would rise sharply and they would become either unprofitable or unsustainable and have to reduce or cease business. But this has not been evidenced, because few have tried extending microfinance on an individual lending model basis. One study, however, claiming to be ‘the first rigorous global study of the relation between MFI gender focus and repayment performance, using a data set spanning 350 MFIs in 70 countries over 11 years’[132] found that (amongst other things) ‘when women are offered individual tailor-made loans, repayment is enhanced, compared to group-lending methods.’[133]

If microfinance as an industry wants to clean itself from the coercive claims that begin to be heard against it, abandoning the group liability model, despite it being its traditional (but not original) plank of its business may be the necessary thing to do: and may not be as painful as MFIs suppose.

[132] Op. cit. note 3
[133] Op. cit. note 3 p768

Chapter 6: Paternalism and its Justification

Whether and which interactions between the MFI and borrower are paternalistic, and whether that is prima facie wrongful or can be justified is a complicated question and unpicked in the following chapter. This chapter examines what we mean by paternalism, when it is justified and when indeed it may be required. This chapter is structured as follows:

I. Definition of Paternalism

II. When Paternalism can be Justified

(a) When autonomy is partial

(b) When beneficial consequences significantly outweigh a trivial infringement to autonomy

III. When Paternalism is not merely Justified, but Required

I. Definition of the Concept of Paternalism

One acts paternalistically towards another when one acts against another's preferences, in a way which undermines or infringes upon her autonomy, for that person's own good, or for the prevention of harm to her. The infringement is prima facie a wrong to her, but I will argue can be justified: either when the autonomy that is infringed upon is only partial, or limited in some way; or when the degree of infringement to a fully autonomous agent's autonomy is low, and the potential good achieved for the agent/harm avoided very high. This second form of justification, essentially consequentialist, is more controversial than the first. Both will be argued for.

The definition I give of paternalism follows that used by Gerald Dworkin, and has a lineage back to Mill, although Mill of course expresses his principle in terms of liberty rather than autonomy.

Gerald Dworkin's formal definition of paternalism is:

> P acts paternalistically toward Q if and only if
>
> (a) P acts with the intent of averting some harm or promoting some benefit to Q.

(b) P acts contrary to the current preferences, desires or dispositions of Q.

(c) P's act is a limitation on Q's autonomy.[134]

'Paternalism' is not used here in a moralised way – like 'exploitation' earlier, it is not wrong by definition, as with 'murder' as opposed to 'homicide'. Dworkin notes that his definition is 'evaluatively neutral in that it does not beg any questions with respect to the legitimacy or illegitimately of paternalistic actions. It makes clear that while the action has a benevolent intent there are normative questions raised by clauses (b) and (c).'[135]

It is the infringement, overriding or undermining of a person's autonomy (albeit for their benefit) that is at the heart of paternalism and makes it prima facie wrongful albeit, like coercion, capable of justification. And, Dworkin argues, it is the infringement of a person's autonomy, not their freedom, because it is possible for an act to be paternalistic without infringing on a person's liberty of action at all. Dworkin suggests the case of a husband who hides his own sleeping pills from his suicidally depressed wife: he does not impinge on her freedom, or for that matter violate any moral rule, or any right of hers: yet this seems a paradigm case of paternalism. Dworkin concludes:

'There must be a violation of a person's autonomy (which I conceive of as a distinct notion from that of liberty) for one to treat another paternalistically. There must be a usurpation of decision-making, either by preventing people from doing what they have decided, or by interfering with the way they arrive at their decisions.' So a wide range of acts can be paternalistic, and they need not involve the use of brute force. 'What we must ascertain in each case is whether the act in question constitutes an attempt to substitute one person's judgement for another's, to promote the latter's benefit.'[136] It is this substitution of the paternaliser's judgement for that of the paternalised that undermines the paternalised agent's autonomy and makes paternalism prima facie wrongful, even if capable of justification through other considerations.

It is the rationale behind a policy that determines whether it is paternalistic or not. A government ban on smoking in public places introduced solely to protect non-smokers from the harm of others' smoke is not paternalistic. Of course many projects have mixed

[134] Gerald Dworkin in Lawrence C Becker & Charlotte B Becker (eds.) *Encyclopedia of Ethics*, 2nd edition (2001) Routledge NY & London p. 1282
[135] Ibid.
[136] Gerald Dworkin, 'Paternalism, Some Second Thoughts' in Rolf Sartorius (ed.) *Paternalism* (1984) Minneapolis: University of Minnesota Press, p. 107

rationales, and it will be seen below that this is certainly true in microcredit. If the government ban on smoking in shared places is not only for the sake of non-smokers, but for the good of smokers as well, then it is to that extent paternalistic.

Paternalism can be applied both individually and to groups. When applied to groups, we need to distinguish what Dworkin calls ‘pure’ from ‘impure’ paternalism.[137] In pure paternalism the class of people whose autonomy is restricted is identical with the class of people whose good is aimed at. An example of pure paternalism is the making compulsory of the wearing of seat belts: everyone who is required to wear a seat belt is a potential beneficiary in the event of a car crash. With ‘impure’ paternalism, the autonomy of people who will not benefit from the policy is also restricted against their will. Illegalising the production and sale of marijuana, for instance, may be done for the benefit of those for whom it is the first step on the road to serious drug addiction, or possibly a cause of schizophrenia. But there is also a class of people for whom smoking marijuana is harmless and indeed a smaller class of people for whom it is an effective and highly desirable pain relief. The policy of making marijuana illegal then would be impure paternalism because it is, of necessity, imposed on all, but only for the benefit of a subset within that.

We will see in the following chapter that paternalistic practices, or practices that at any rate pass for being paternalistic, are rife in the field of microcredit. So in what sort of circumstances might paternalism be justified, given the importance given here to autonomy, especially respecting the desire of individuals to be their own self-creators, to lead their own lives?

II. When Paternalism can be Justified

It is argued here that paternalism can be justified in two ways. Firstly, it can be justified where autonomy is already impaired or absent and cannot be exercised by the agent in the sphere to which the paternalism applies. In such cases, the paternaliser does substitute his judgement for that of the paternalised agent, but only where the paternalised agent is unable to come to a fully autonomously reached judgement himself. Secondly, more arguably, paternalism can be justified when the beneficial consequences to/harm avoided by the subject

[137]E.g. in his entry ‘Paternalism’ The Stanford Encyclopedia of Philosophy (Summer 2010 Edition), Edward N. Zalta (ed.), URL = <http://plato.stanford.edu/archives/sum2010/entries/paternalism/>.

of the paternalism are sufficiently known to the paternaliser and significantly outweigh the infringement of the subject's autonomy. The epistemological point about the true confidence that the paternaliser can have in the outcome is not a small caveat. Merely being of the opinion that a significant benefit will accrue to an unwilling subject from the paternal intervention is not enough, on this account, to justify it: the paternaliser has to really know it is highly likely to.

The second part of this defence of some paternalism is more clearly a consequentialist one. Consequentialists, including utilitarians, will be able to justify paternalism when it results in more pleasure or happiness or superior consequences for the welfare of the person whose autonomy has been usurped, all things considered. Nonetheless, consequentialists will rule out quite a lot of paternalism on the grounds that it often will not actually end up benefiting the person whose good is at stake, because he knows his own prudential interest best, certainly better than 'we', outsiders or the state, can, or because the cost of the interference weighs heavily with him. Side-effects on the rest of society may also be taken in to consideration.

The defence of some forms of paternalism presented here incorporates both possible justifications: when autonomy is only partial, or there is a defect in it, and a more consequentialist approach. Despite the central importance given to autonomy here, the position that paternalism should be treated as taboo *except* in cases of defective autonomy, is not defended. It will be argued that this principled anti-paternalism is too strong. There can be cases where a fully rational, autonomous agent's will may be overridden, where the benefit to him is genuinely known to be great, or the harm avoided very large, and the infringement to his autonomy trivial. Although they may not be extensive, it will be argued that some cases of what Joel Feinberg defines as 'hard' paternalism can be justified. And though they may be even fewer, it will be argued in Section III that there are some rare cases where hard paternalism can actually be required. It will then be argued in Chapter 7 that microcredit provides instances both of where apparently justified paternalism is claimed but is not in fact paternalistic at all: and instances of where a degree of hard paternalism is indeed required.

We can start with cases where the position defended here overlaps with the antipaternalistic position: cases of what Feinberg calls 'soft' or 'weak' paternalism.[138]

(a) Justification of Paternalism I: When autonomy is partial

Hard paternalism, as defined by Feinberg[139] is the interference with a fully voluntary choice of a competent adult, against his will, for his own good. Soft paternalism is interference when the choice is less than fully voluntary. Although on the account given here it is interferences with choices that are autonomous that makes paternalism prima facie wrongful, there will clearly be much overlap with when a choice is less than fully voluntary, and when it is less than fully autonomous.

Although I will defend occasional use of hard paternalism, it is important to justify the use of even soft paternalism, even where there is something less than ideal in the autonomy of the agent making the decision. We do not want to allow interference in all and any less than fully autonomous decisions: a serious harm or loss of benefit to the agent has to be at stake, to begin with. And as Mill makes clear in his passionate defence of those 'in the maturity of their faculties' to decide what is best for themselves provided it harms no others, we need to allow people to make bad choices (especially where the consequences of doing so are not irrevocable or excessively harmful): people need to learn from their mistakes to develop a full autonomy. As outlined in chapter 2, the highest value of autonomy lies in our using it to develop and evolve in to the people we want to be and become. That, however unconsciously, is a constant process of iteration, so any interference with our autonomy, even a trivial one, interferes with that valuable process. That is not to say that such an interference cannot be justified, but that the harm avoided/benefit gained must itself be more than trivial, must be much more than someone else's preference for how we should live, to justify the interference.

Soft paternalism then is distinguished from hard paternalism by the infringement to autonomy or freedom being imposed on an agent whose decision-making ability is already impaired in some way. He either does not possess a full, rational autonomy (children, the mentally disabled) or his decision-making ability in this particular instance is impaired in some way (he is ignorant of the facts crucial to his choice, or he is subject to some type of coercive

[138] Joel Feinberg *Harm to Self*, vol. 3 of *The Moral Limits of the Criminal Law* (1986) New York: Oxford University Press esp. chapter 20 pp. 98-143
[139] Ibid. p12

influence.) Soft paternalism is interfering with the agent when his own decision-making is judged in some way substantially non-voluntary, or non-autonomous, whether that be because the agent has a diminished autonomy, or because his situation has diminished his autonomy. It is the fact that autonomy is not undermined by paternalism here – because in this instance it is absent or only partial – that justifies the soft paternalism. Of course, on this justification, the degree of paternalism used must be proportionate to the degree of autonomy absent, and in the relevant area.

As was discussed in the opening chapter, autonomy is something we hold in degrees – both our autonomous agency and our ability to act autonomously in any given sphere. Our autonomy of action is limited by various external factors or physical incapacities of our own. Our autonomous agency is also held in degrees: one person can have a greater capacity to think rationally and reflect coolly, giving him a greater degree of agency than another. Importantly here are the range of cases where the ability to act rationally and self-reflectively is only partial: from the child developing her ability to be rational, to the patient in a persistent vegetative state (PVS) who has no capacity for autonomy at all. A paternalistic policy imposed on a fully autonomous agent is a prima facie wrong to her, though possibly capable of justification. A paternalistic policy imposed on a partially autonomous agent (a child, one suffering from mental illness) is a case of potentially prima facie justifiable paternalism, provided it is in the area where her agency is only partial and not, for example, over an area where she can make rational decisions. We might be justified in withholding alcohol from a recovering alcoholic who has voluntarily sought treatment in a clinic, but whose illness is now overcoming his previous desire to recover and is now demanding a drink, but we would not be justified in insisting he eats all the vegetables that come with his meals if he hates them.

The paradigm case of paternalism, the parent and child, is paternalistic because the child has partial autonomy, has some rational capacity and is gaining more, and the parent has constantly to adapt as the child develops to recognise the growing autonomy, and cease forms of parenting that were perhaps justifiable paternalism at one stage of development but are not at another. When rational agency has altogether gone, respecting autonomous preferences becomes impossible. The best that can be done for the PVS patient is to ask, as O'Neill puts it,[140] 'What would this patient have chosen in this situation?', trying to respect the decisions

[140] Onora O'Neill 'Paternalism and Partial Autonomy', (1984) , *Journal of Medical Ethics* 10 p. 173-8

the patient is likely to have made 'as he or she was in former times' – but 'respect for absent autonomy can at best be vestigal.'

Soft paternalism, then, can be justified by the very absence of autonomous judgement that it substitutes for. Such a justification is limited to the extent to which autonomy is partial, and indeed this justification is more restricted than that. Where a parent interacts with a child paternalistically *all* the time, the child may hardly have a chance to develop his autonomy. In such a case, where otherwise possibly justifiable paternalism is in fact hampering the growth of autonomy, the restriction would be to fewer cases: the child needs to be allowed to learn from making a few bad choices (provided no great harm results.) This latter case then bridges the two justifications of paternalism: the justification of it when autonomy is only partial, and the justification of it where the consequences are sufficiently known and beneficial.

(b) Justification of Paternalism II: When the beneficial consequences significantly outweigh a trivial infringement to autonomy

The second justification of some forms of paternalism that I shall defend, is where autonomy is not all absent or partial, but fully present, but the compounding of the size (i.e. small) of infringement to it with the benefits to the paternalised agent arising from it (i.e. high) provide a consequentialist justification. Feinberg does not believe that the second of these justifications is possible. He argues[141] 'There is no such thing as a 'trivial interference' with personal sovereignty; nor is it simply another value to be weighed in a cost-benefit comparison. In this respect, if not others, a trivial interference with sovereignty is like a minor invasion of virginity: the logic of each concept is such that a value is respected in its entirety or not at all.'

Yet surely here, for all the importance given to autonomy here, in this Feinberg goes too far. He is arguing against Gerald Dworkin's claim that some interferences with autonomy – such as requiring motorcyclists to wear helmets, or passengers in cars to wear seat-belts – are relatively trivial, and outweighed by the possible prevention of great harm that not wearing them risks. That leaves Feinberg in the awkward position of later justifying such apparent cases of hard paternalism by claiming that they are not paternalistic at all, but driven by the desire of society not to bear the costs of accidents after these safety measures have been

[141] Op. cit. note 138, p.94

ignored, or alternatively the desire of society not to suffer pangs of conscience watching the wretched lives of those involved in such accidents, where society declines to pick up the cost and the individual cannot bear it himself. Thus he justifies enforcing the wearing of brightly coloured clothes on those walking in woods during the hunting season as being for the avoidance of the harm caused to hunters through their feelings of guilt after they accidentally shoot walkers, rather than (paternalistically) for the protection of the walkers themselves. But whilst he might justify such an intervention that way, it seems likely those writing the regulations followed a more natural, if paternal, instinct.

The root of what generates this problem for Feinberg is his belief that personal sovereignty is inviolable. Yet is it really the case that autonomy is all-or-none, that there cannot be minor breaches of it? In our earlier discussion of autonomy, we considered the thresholds for autonomous agency and autonomous actions. It was argued that agents have a wide range of autonomy: from only-just threshold competent (in some areas) mentally impaired adults, to one blessed with every capacity to develop his own conception of what represents the good life to him and endowed with resources to pursue that conception. Autonomy, it was argued, is actually held in degrees, but the heart of it was held to be our rational capacities to determine our own lives, to pursue our own conception of the best life for ourselves, whatever that may be and however circumstances may have limited it.

Feinberg, then, tries to stop his sliding scale justification of soft paternalism slipping in to justification of some hard paternalism at the far end of his scales where the consequences weigh heaviest, by relying on an inviolability of personal sovereignty that seems to stretch the notion too far. The argument I present places high value on autonomy, but does not hold it inviolable. Its value could be outweighed by other values. Thus this account accepts that there is no cut-off point that can stop soft paternalism at the very extremes sliding in to hard paternalism where the balance between minor infringement to autonomy and severity of consequences is heavy enough.

Given this thesis' emphasis on the value of autonomy, allowing for the possibility of hard paternalism will be controversial. The most ringing condemnation of hard paternalism is of course Mill's in *On Liberty*:

> The sole end for which mankind are warranted, individually or collectively, in interfering with the liberty of action of any of their member, is self-protection. That the only purpose for which power can be rightfully

exercised over any member of a civilised community, against their will, is to prevent harm to others. His own good, either physical or moral, is not a sufficient warrant.[142]

Even with Mill, however, there are exceptions, such as children and those 'in a state to require their being taken care of by others'.[143] And his bridge example suggests that presumed ignorance may also justify soft paternalism (at least while the ignorance is being repaired.) He famously states: 'if either a public officer or anyone else saw a person attempting to cross a bridge which had been ascertained to be unsafe, and there was no time to warn him of his danger, they might seize him and turn him back.'[144] But they may do so only because he is acting in ignorance as to the safety of the bridge. His true interest is simply in crossing the river: at least we are assuming that that is what he aims to do, rather than plunging in to the river when the bridge collapses. If he is warned, but being of suicidal bent decided to cross anyway, then he must be allowed to.

Young[145] notes that Mill's opposition to paternalism stems from his commitment to liberty as the means by which we can best develop our capacities. He distinguishes four grounds on which Mill argues against paternalism:

1. Competent people know their own interests better than others (especially governments) do[146];

2. Paternalistic interferences (especially by governments) are prone to error because they rely on general presumptions, not direct knowledge of the individual[147];

3. Paternalistic interference fails to show respect for individual liberty, which is vital to treating people as equals[148];

4. Since exercising liberty is instrumental to developing our own characters, we need to be able to make mistakes to do so.[149]

The fourth of these arguments seems the strongest. With regard to the first, certainly people generally know their own interest best: but, as seen above, Mill allowed that this

[142] John Stuart Mill, *Collected Works XVIII, Essays on Politics and Society (On Liberty)* (1977) Toronto: Buffalo: University of Toronto Press p.223
[143] Ibid. p.224
[144] Op cit. note 142, p. 294
[145] Robert Young 'John Stuart Mill, Ronald Dworkin, and Paternalism' In C.L.Ten (ed.) *Mill's on Liberty: A Critical Guide* (2008), Cambridge University Press p211-2
[146] Op. cit. note 142 p.277
[147] Op. cit. note 142 p.283
[148] Op. cit. note 142 p.263
[149] Op. cit. note 142 p.283

generalisation allowed of plenty of exceptions. It simply does not appear empirically true that people always do know their own interest best, or necessarily always act on that knowledge when they have it. The second argument is a similar generalisation, and capable of exception. Perhaps we do not always need direct knowledge of an individual. Mill tells us that we cannot rightfully compel a person ‘to do or forbear because it will be better for him to do so, because it will make him happier, because, in the opinion of others, to do so would be wise, or even right.’[150] But this is a softer rejection of paternalism. We may not compel when in our opinion that would have the best consequences: but what if we actually know? Know, not because we know this individual personality (though we may) but because we know more about the certain consequences of some actions today than we did in the nineteenth century. Would Mill allow a paternalistic act where we are certain of superior consequences, however unusual that epistemic situation might be? Perhaps not, because the emphasis Mill gives to each person having to learn for themselves in order to fuel their own self-development, and possibly also because their personal (even if wrong-headed) experiment in living adds to the utility of us all by enabling us to see the success and failure of other attempts at life.[151] Still, the point implicit here that it is not just whether in our opinion the consequences of intervention will be better for an agent or not, but the degree of confidence we can have in that view, is important and will be returned to.

The third argument also does not seem quite right. Exercising paternalism may fail to show respect for individuals: but it can also actually demonstrate that respect. Where we paternalise an agent who has only partial autonomy, we may respect her more by recognising the vulnerability and adjusting to it, than by ignoring it and neglecting the fact that impairment to autonomy requires special treatment, even if in some degree paternal. When we act paternally towards children and teenagers, we do not (necessarily!) lack respect for them as individuals, but rather attempt to find the furthest reaches of their autonomy with which we can let them exercise it safely. If instead we treated a child as having the full decision-making powers of an adult, this callous disregard of her actual state of development shows less respect for her than a careful contemplation of the boundaries of it.

[150] Op. cit. note 142 p.223-4
[151] Skorupski argues in addition that Mill’s particular objection is to paternalism from public officials rather than close personal friends; that the ‘menancing indirect consequences of giving the state or society powers to interfere may indeed justify a ban on paternalistic moral practices or laws which is in practice absolute.’ He adds that Mill’s ‘opposition to paternalism is consequentialist; based on a fear of the ‘tyranny of the majority’, and a high estimate of the good consequences of letting people make their own decisions. If we add into the analysis the independent categorical end of autonomy, we simply strengthen an essentially Millian case.’ *John Stuart Mill* (1989) London: Routledge, p. 360

Young has most sympathy for Mill's fourth argument, and given the emphasis in this thesis on placing value on autonomy in order to achieve our self-development, this view is shared: but as Young observes, the fact that individuals need to be able to err to self-develop, and that great happiness lies in self-development, does not show that the cost to liberty will always outweigh the harm avoided.

So on closer inspection, it is not clear that Mill's arguments for his strong antipaternalism are fully convincing: and of course even he allowed the exceptions we have seen, where autonomy is only partial, and indeed, where an agreement or contract was proposed that would permanently and irrevocably renounce the liberty necessary for self-development: paradigmatically, slavery, but also all perpetual contracts.

It has thus been difficult to draw a hard line between soft and hard paternalism using either Feinberg's boundary of what is voluntary, or Mill's restriction on interference with liberty to only when harm to others is at stake.

The consequentialist defence of when paternalism can be justified allows that, at the extreme, soft paternalism can merge in to hard paternalism: it is a continuum with no sharp dividing line. Nonetheless, there is an important theme throughout Mill that should be applied to any consequentialist justification of hard and soft paternalism, which is the concern with regard to the state of our knowledge. We cannot ignore the fact that our calculus should be adjusted to reflect the certainty we are entitled to have in our judgement. Individuals do generally know their own interest best: so the consequential justification of some paternalism should not be

Significance of harm avoided/benefit gained (A) x Infringement to Autonomy (B)

but

Significance of harm avoided/benefit gained (A) x Infringement to Autonomy (B) x Certainty of A

Although this position, then, rejects a principled antipaternalism, by the time all the factors in the calculus given above are taken fully into account, there may not be so much practical difference between what this account and that of Mill might allow.

A second clarification of this justification of paternalism is needed. Autonomy has been argued to be held in degrees, and we of course have not only different levels of autonomy, but have it to different degrees in different areas of our lives. It has also been argued that it is the aspect of autonomy that is represented by our projects of self-development, of trying to determine the sort of people we become (and do not become) that is the most valuable. So in this calculus, some infringements to autonomy weigh rather more heavily than others. The severity of consequence needed to overcome infringing on my autonomy to act in some relatively trivial matter is at one level: that for overcoming an infringement to my ability to use my rational agency to help bring about becoming the person I want to be, much heavier.

To summarise, I argue that the value we are compounding by the harm/benefit is not the degree of voluntariness, but the degree to which the imposition infringes upon an agent's autonomy, and especially his ability to determine his own life, his project of self-development. This will overlap with Feinberg's (and Mill's) limits to a very great extent but not wholly. A fully voluntary decision could reasonably be overridden where the potential harm was extremely great and the autonomy infringed minor: the making compulsory of the wearing of seat belts is thus allowed as straightforward justified paternalism, rather than, as with Feinberg, a sort of prevention of harm to others through avoiding their pain at observing the injured person's condition. Using autonomous agency rather than voluntariness will see substantial overlap with Feinberg's soft paternalism, but it will justify hard paternalism in some cases.

Some examples of how these different approaches might play out might help. I shall consider the following: the choice of a Jehovah's witness to die rather than undergo a blood transfusion: and whether we would allow the suicides of various different categories of person.

Questions of Choosing Death

Jehovah's Witness's religious beliefs hold against allowing followers of the religion blood transfusions, with fatal results on those occasions when one is necessary. Must an autonomous decision not to have a medical intervention that would save one's life be respected? Feinberg says yes[152] and one imagines that Mill would. On the calculus that the

[152] Op. cit. note 138 p. 181

consequentialist giving heavy weight to autonomy uses, the harm prevented by paternalistic intervention is of course extremely great: but so here is the infringement to autonomy. The Jehovah Witness's beliefs are a key part of his self-conception and who he wants to be. On those grounds, even the consequentialist calculus will find this finely balanced. There is a great temptation to override the Jehovah Witness's autonomy in this case, where we know with great certainty the great harm that will come to him if we do not intervene. Great harm x certainty of it weighs heavily: but so too does the Jehovah Witness's views on who he wants to be and his knowing, voluntary choice to die rather than live in contravention of his beliefs. I conclude that in this instance paternalism would not be justifiable, but perhaps only just.

This example presents a problem for the consequentialist calculus: if minimal autonomy is defined as rational agency and self-reflection (as it has been), why should we give that autonomy weight when the beliefs that are held appear to be irrational, if not downright delusional? Here, we need to distinguish between apparently false, irrational beliefs that are symptomatic of a psychiatric condition, and those which are perhaps extremely poorly based in terms of evidence, but are still the product of a rational thought process. The former type – the schizophrenic with delusions that there is a global conspiracy to persecute him – cannot be argued with: there are no arguments that we can present to him that he will not twist in to a further complication of his view. The latter we can engage in reasoned argument, even if our chance of success is poor if an individual has been indoctrinated with a particular religious or political view from an early age and given no exposure to other beliefs or views. But the rational agency is there, if buried beneath a weight of false beliefs: the unfortunate schizophrenic can be treated (if we can find a way) but not persuaded.

To take some other cases, here of actively sought suicide. Arneson[153] postulates Tom, the Pouting Young Adult, whose distress at some disappointment he has suffered (losing out in the race for a job he wanted, being dumped by his girlfriend) is so extreme, he wants to commit suicide. He knows that if he lives, time will heal and he will want to live on and resume his life, but he has unusually self-indulgent and immature preferences, and wants to die. Arneson also imagines a terminally ill cancer patient who has little time left to live, can only suffer horribly, and wants to die. Let us also add to our suicide line up Juliet, awaking in the mausoleum to the devastating sight of her dead ancestors, the freshly killed Paris and of

[153] Richard Arneson, 'Joel Feinberg and the Justification of Hard Paternalism', (2005) *Legal Theory* 11 p. 278

course worst of all, Romeo dead by his own hand, falsely believing her dead rather than drugged.

There are three competing approaches. The Kantian approach is commonly taken to rule out all suicides on the grounds that what is of value in us is our capacity for rational agency, and no act that destroys the possibility of the future exercise of that rational agency can ever be right.[154] This approach would disallow all three suicides (cancer patient, Pouting Young Adult and Juliet.)[155] Arneson argues that Feinberg would find paternalistically interfering to prevent the suicide of both the terminally ill cancer patient and the Pouting Young Adult unjustifiable. We can imagine though that he would prevent Juliet's suicide on grounds of it being sufficiently involuntary, given her age (13) and the circumstances of having just awoken from a powerful drug and then being immediately presented with the catastrophe around her. Yet not preventing the Pouting Young Adult from committing suicide, at least for a time, given that we postulate that he will come to see value in life again, may seem excessively liberal. Arneson's approach would allow the cancer patient to end his suffering, but prevent Pouting Young Adult from carrying out his suicide on the grounds that the agent is not deceived about his situation, and chooses voluntarily enough, but does so 'to satisfy basic desires that strike many of us as bad, perverse or distorted.'[156] Arneson would presumably also preserve Juliet, at least for the time being, until we can see if in a future period she can conceive of a life without Romeo – at the time of her suicide, we do not know this.

Of these approaches, I would argue that Arneson's does the best job of picking out those we feel intuitively should be allowed to commit suicide, and those not (or, at least, not now.) This is because, if we use the above approach of treating as all-important the kernel of autonomy, the rational agency required, as Arneson puts it, 'to make something worthwhile

[154] Allen Wood argues that there is an exception to this general rule of Kant's, where the suicide is motivated by respect for the worth of humanity and protects dignity of rational agency. In support of this he quotes Kant's comments on the case of Cato in *Vorlesungen Über Ethick, Immanuel Kant's Schriften* vol. 27 p 370-1 (Berlin: W de Gruyter). Cato kills himself to avoid capture by Caesar: Wood quotes Kant: 'It appears, then, that he saw his death as necessary; he thought: since you can no longer live as Cato, you cannot go on living at all. In this example, one must freely concede that in such a case, where suicide is a virtue, it has a great appearance of plausibility in its favour. But this is the sole example that the world furnishes us in which suicide can be defended.' *Kant's Ethical Thought* footnote 37 p. 372, Cambridge: Cambridge University Press

[155] If Wood's interpretation of Kant is correct, perhaps Kant would allow the cancer patient his suicide however. As Wood observes, Kant's exception for Cato could be read so that 'anyone faced with a dehumanizing terminal illness is in a position to say something of the form: "Since you can no longer live as Cato, you cannot go on living at all.' Ibid.

[156] Op. cit. note 153 p. 279

of our life',[157] to conceive of our lives as something of value because of our self-construction, then where a self-constructed worthwhile life is no longer to be had, the importance of the rational agency necessary to pursue it shrinks accordingly.

Arneson saves Tom the Pouting Youth because he considers that Tom's desires are bad, and that Tom has a duty to make something of his life. I do not wish to argue the case that we all do have such a duty to make something of our lives (duty to whom?) although I do not need to deny the possibility of this. But if I do not follow Arneson in arguing that we have such duty, then I need to offer an alternative argument for why we might save Tom. This is that Tom is suffering from a temporary irrationality (Juliet certainly is.) Tom does recognise that he will feel differently in the future: he just does not, at present, care – he gives a wholly irrational weighting to his current preferences and a false discount rate to his future ones (Tom is not alone amongst humanity in doing this, but a form of irrationality, even if as widespread as a low ability to discount future pleasures and pains effectively, is still a form of irrationality.) Tom just takes it to an extreme. His inability to discount the future anything close to adequately is a form of irrationality, which thus undermines his autonomous agency and justifies our paternalistic interference.

I am arguing, then, that Tom may be preserved because he holds a desire to die that is in part the result of his (all too human) inability to discount his future preferences adequately, a failure of his rationality which thus produces an irrational desire to die now. It is also important in the example as Arneson postulates it, that Tom does know that he will feel differently in the future, he is just unable to act on that now. If he knows that, we may be assumed to as well (his evidence being the best), which relieves the epistemic issue in the example. I am not left, as Arneson is, with the need to adjudicate on good, bad or perverse desires.[158]

It might be that Mill would also save Tom, because of the irreversibility of Tom's decision, and his youth and lack of experience in making it. In writing of when exceptions to his normal ban on paternalism are possible, Mill notes:

> A second exception to the doctrine that individuals are the best judges of their own best interest, is when an individual attempts to decide irrevocably now, what will be best for his interest at some future and distant

[157] Op. cit. note 153 p. 280

[158] Note that if Feinberg were persuaded by the argument that I put forward here that Tom's low ability to discount the future effectively makes him irrational rather than just unreasonable, he might too then save Tom on the grounds that the irrationality makes his decision less than fully voluntary.

> time. The presumption in favour of individual judgement is grounded on actual, and especially on recent, personal experience: not where it is formed antecedently to experience, and not suffered to be reversed even after experience has condemned it.[159]

These examples show that autonomy weighs very heavily in the consequentialist calculus presented here. It outweighs even a choice that results in death, as with the Jehovah's Witness refusing a blood transfusion or the cancer patient. It does paternalistically save Tom, but not the cancer patient or the Jehovah's Witness, because we know – indeed Arneson's example stipulates that Tom knows, but that that does not motivate him to care – that his views will change in the future. The cancer patient is very unlikely to have such a change in view, because his painful condition will not change and any future project of self-development is not available to him. The Jehovah's Witness is taken to be mature and his religious beliefs central to his own conception of himself, so again it is unlikely (though less so than with the terminally ill cancer patient) to change. Still, this remains a finely balanced decision. The younger the Witness (certainly a child) and the more subject to familial religious influence, either factor casting in doubt the fullness of the autonomous decision, the more it would be likely to be swung the other way.

It is the notion of autonomy to create ourselves, the people we want to be, that is carrying the weight here. When we consider merely autonomy to act freely in a particular way that is not crucial to our self-conception, this is an infringement to autonomy, but one easier to outweigh if the consequences are severe enough. So we need to distinguish our ability to act autonomously in a particular case, which can be outweighed, from our autonomous setting of our life's projects, infringing which is much harder to justify, at least when set fully rationally.

This is to give our autonomous self-development a very high value and weighting in the calculus such that it will seldom be the case that overriding it can be justified: but the theoretical possibility remains. The principle of consequentialism is the prior principle, but our self-development looms a large factor in achieving the best consequences for ourselves. Mill placed his importance on self-development even more closely to his utilitarianism when he wrote: 'I regard utility as the ultimate appeal to all ethical questions; but it must be utility grounded on the permanent interests of man as a progressive being',[160] with the permanent

[159] John Stuart Mill, *Collected Works III, Principles of Political Economy with some of their Applications to Social Philosophy* (1977) Toronto: Buffalo: University of Toronto Press, p. 953.
[160] Op. cit. note 142 p. 224

interests of man as a progressive being here being our potential for self-development. But in his absolute condemning of paternalism other than when the subject is ignorant or immature, Mill treats autonomy, or liberty as he describes it in *On Liberty*, as inviolable in the same way as Feinberg treats personal sovereignty: that all incursions upon it are equally grave. The view defended here is that they are not: those relating to our self-development are much more serious than those only relating to autonomy to act, which can be outweighed.

To summarise, then: paternalism is prima facie wrongful, but can be justified. Not by when an agent's act is sufficiently involuntary, compounded by the harm/benefit being great enough, as per Feinberg: but when it is only a part of an agent's autonomy that is not critical in his self-determination, in his choosing the life he wants to lead for himself, compounded by the harm/benefit involved, and by a high degree of certainty on the part of those being paternal of the harm avoided/benefit gained in the outcome.

This latter approach will overlap with that of Feinberg much of the way, but will also justify some instances of paternalism such as the wearing of seat-belts where Feinberg has to go to extraordinary lengths to find non-paternalistic reasons to justify the same policy, dwelling on the disutility of externalities, rather than the fact that the policy impinges only lightly on the area of autonomy that most concerns us, and prevents the most serious consequences for the agent.

Before taking this autonomy approach to paternalism, and using it in considering the daily practices of microcredit, it remains to also consider the theoretical possibility that paternalism may sometimes not only be justified, but may also in fact be required.

III. When Paternalism is not merely justified, but required.

Section II has argued for when paternalism, though prima facie wrongful, can be justified. There is very little discussion, with the exception of some of Arneson's work, on when paternalism might not only be justified, but required. Arneson argues that it can be required, in some circumstances, as a matter of social justice. I shall argue that there are circumstances in which one party in a transaction owes a duty of care to another, and can only exercise that duty of care paternalistically. Where that is so, paternalism would not only be justified, but required.

The Duty of Care

It would be best to begin by defining what I mean here by a duty of care, and who owes it to whom, because as a term it is well defined and understood in UK and US law, but has latterly been used to suggest a wider, more extensive set of obligations in medical, virtue and care ethics. When I refer to a duty of care, specifically in this thesis as applying to microfinance, I refer to the established, legal duty of care that is the cornerstone of the law of tort in the UK. This comes with fewer obligations than when the term is sometimes used in medical and virtue ethics; but has the advantage of these obligations being better defined, clearer to ground in moral principle and of wider application (to any profession or transaction, including finance), when it is applied.

The obligation that the legal duty of care imposes, is that one party may not cause harm to another when providing a good or service to him where the supplier of the good or service can foresee, or can reasonably be expected to foresee, that the recipient cannot judge for himself whether or not the good or service is harmful to him. If the duty of care is breached, the party owing the duty of care becomes liable for paying damages to the party to whom the duty was owed. As Raz puts it:[161]'Morally speaking we have two (kinds of) duties: a duty of care and a duty not to harm by negligent breach of duties of care. In other words, there is a moral duty whose point, and therefore whose content, is to protect people from negligent harm.'

The phrase 'duty of care' in medical ethics, or sometimes 'duty to care', is used of a doctor's duty to his or her patients, and goes well beyond a duty to do no reasonably foreseeable harm. It is closer to a fiduciary duty: the International Code of Medical Ethics[162] states that 'a physician shall owe his patients complete loyalty' and the debates of the boundaries of a doctor's duty of care focus around how far he has a positive duty of beneficence, even at the cost of self sacrifice, to serve his patients' best interests, rather than merely an essentially negative duty to do no harm.

In care ethics, (and virtue ethics to the extent that care is seen as a virtue and subsumed within it), care (for ourselves, the environment, each other) becomes central, the basic feature

[161] Joseph Raz, *From Normativity to Responsibility* (2011) Oxford: Oxford University Press, p.262
[162] World Medical Association. International code of Medical Ethics. World Medical Association Bulletin 1949; 1(3): 109, 111.

of a moral theory. Again, this is a very different interpretation of a duty of care than the older, simple and more restricted principle of doing no (foreseeable) harm that is used here. The duty of care as used here is the legal use. This is distinct from a more extensive duty of care in medical ethics, which has wider boundaries and has its moral grounding in trust and loyalty, or from that of care ethics, where as Tronto puts it, 'the ethic of care is a practice, rather than a set of principles.'[163] But to be quite clear, the legal definition of when a duty of care applies is used here not because it derives ethical status from being part of the law per se, but because it best describes the narrower circle of circumstances in which a requirement for hard paternalism could arise.

The legal position on who owes whom a duty of care was reshaped in English and Scots law in the seminal decision by the House of Lords in the case of Donoghue v Stevenson, 1932. In his leading judgement (which allowed the appeal of Donoghue to claim for suffering caused to her by ingesting parts of a decomposing snail in a ginger beer bottle manufactured by Stevenson), Lord Atkin expounded his 'neighbour' principle which, though he derives it from Christian principles, seems to owe as much to Mill's harm principle. He wrote:

> The rule that you are to love your neighbour becomes in law you must not injure your neighbour; and the lawyer's question: Who is my neighbour? receives a restricted reply. You must take reasonable care to avoid acts or omissions which you can reasonably foresee would be likely to injure your neighbour. Who, then, in law, is my neighbour? The answer seems to be – persons who are so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so affected when I am directing my mind to the acts or omissions that are called in question….A man has a Duty of Care to conduct himself in such a way as to avoid harm to others, where a reasonable man would have seen that such harm would occur.

The Lords found that when a manufacturer sells a bottle of beer in darkened glass, so that the ultimate consumer has no possibility of inspecting it before opening and drinking it, then the manufacturer has a duty of care to the consumer to be absolutely sure that no noxious substances can get in to what he sells between the product leaving him, and reaching the consumer. This landmark decision opened up modern negligence law, such that a provider of services or goods has to ensure they are fit for the purpose intended, whoever ultimately uses them, regardless of whether there is a contract between the ultimate consumer and original provider or not.

Of course, it was understood at the time that enshrining a principle of doing no (foreseeable) harm to those one interacts with would open up the law of negligence dramatically, as it did,

[163] Joan Tronto, *Moral Boundaries: A Political argument for an Ethic of Care* (1994) New York; London: Routledge. The four elements of care to be practiced are attentiveness, responsibility, competence and responsiveness.

so that the original constructors of bridges and buildings, or polluters of land, can now be held liable for negligence to those using the construction many years, and owners, after it was first built. And it was always understood that there would be particular difficulties with inherently dangerous products – kitchen knives were cited – where it was argued that to allow sale, overall benefits had to outweigh the risks.

The duties of the seller to the buyer appear to ratchet up in line with the state of the equality of power and autonomous agency between the two parties. Caveat emptor, let buyer beware, is less common today as a governing rule of transactions than it used to be, but is still regarded as appropriate where both buyer and seller are equally matched, understand what they are doing and the product is not potentially harmful to the buyer.

A duty of care begins to apply where both parties are not equal with regard to a transaction; where the buyer of a good or service is in some respects the non-expert to the selling expert; where the buyer's ability to act autonomously with regard to the purchase is restricted by his relative ignorance; and the product is potentially harmful. It was important in Donaghue v Stevenson that the ginger beer was sold in darkened glass: Donaghue's ability to act to inspect it herself first before committing to opening it was impaired.

Frequently, the impairment to the purchaser's autonomy that prevents her from being able to truly assess whether a product is appropriate for her or not, will come about from her ignorance of the technical detail she might need to know in order to make a decision. The ordinary passenger in an aircraft cannot be expected to be an expert in metal fatigue and capable of judging if the wings are about to fall off. Medicine, of course, is a common area where a duty of care is required, and indeed where that duty of care may sometimes only be exercised paternalistically.

A seriously ill patient may demand drugs he has heard will help him but which his doctor believes will in fact further harm him. Whilst the doctor will do his best to get a genuinely 'informed consent' to his recommended treatment, in this situation a life-time's experience in understanding the complexities of the condition can only occasionally be condensed in to a similar level of understanding in the zero-experienced patient. Where one party has all the expertise and is recommending (or, here, refusing to recommend) a potentially dangerous product to the uninformed, the duty of care apples. The doctor may sometimes be forced to choose between his duty not to harm and his preference to respect the patient's autonomy. Here, because the decision not to give the drugs is required by the duty of care, and goes against the very clearly formed will of the patient, it is not only a case of justifiable paternalism, but one of required paternalism.

Note, though, that whilst the duty of care is being applied here in a medical context as on occasion not only justifying but requiring paternalism, the fuller duties sometimes held by medical ethicists to be part of a doctor's duty of care are not here being appealed to. This is not to deny that a doctor has the fuller obligation not only not to harm his patient, but to act in his best interest: but it may be better to think of this as part of a doctor's fiduciary duty to his patient, rather than extending the 'no-harm' duty of care principle to cover these fiduciary duties as well. The fiduciary duty to act in a patient's best interests may well encompass the 'no-harm' duty of care, but the no-harm duty of care does not encompass further fiduciary obligations. The legally-scoped duty of care is narrower in scope, covering only a duty not to harm, but wider in application, to transactions and professions well beyond those involving fiduciary obligations.

The reason for distinguishing the doctor's more positive duty to act in her patient's best interest (or a teacher's to her class, or a lawyer to his client perhaps) is that these more fiduciary type of obligations are both more extensive than the (no-harm) duty of care, and more restricted in the number of transacting relationships (in principle, all) where a no-harm duty of care could apply. The risk of using the term 'duty of care' in the wider, fiduciary sense might be that we then deny it applies to certain transactional relationships where whereas in fact the more limited 'no-harm' duty of care still does apply, and can still do useful work. A limited paternalism from the expert is demanded in many exchanges.[164] A limited paternalism may thus not only be justifiable, but on occasion, required, where the duty of care holds.

And it is indeed not only in the practice of medicine that we expect a limited paternalism on the part of the expert seller to the non-expert buyer. In developed countries (at least) financial transactions are regulated differently according to whether they are expert-expert or expert-non-expert. In the former – transactions between qualified professionals essentially – caveat emptor (broadly) applies. Caveat emptor works best where there is roughly equal knowledge between buyer and seller. Thus for qualified, authorized traders in securities markets, there is a much more lax set of protections for buyers than, for example, for the general public trading

[164] See, e.g. Onora O'Neill, *Autonomy and Trust in Bioethics* (2002) Cambridge: Cambridge University Press

with professional stockbroking firms (although misrepresentation would not be allowed in either case.)

It may seem that what generates the duty of care is the fact that the transaction is between expert and non-expert, rather than because what is transacted is potentially harmful to the purchaser. This is probably not so. A non-expert selling a potentially seriously harmful product to another non-expert would still have this duty (though his sale would probably be illegal, as unregulated.) And there are plenty of expert to non-expert transactions where a duty of care is not taken to hold: it was not required of digital TV salesmen in the UK that they ensure the potential purchaser could actually receive the digital signal before making the sale. What rules apply to the transactional relationship between expert and non-expert can simply be cultural, the place at which a particular society has chosen to draw its own lines, involving no duty of care. The Cambridge economist Ha-Joon Chang expresses his surprise on arriving in the UK in the 1980s that 'one could demand a full refund for a product, even if it wasn't faulty. At the time, you just couldn't do that in Korea, except in the most exclusive department stores. In Britain, the consumer's right to change her mind was considered more important than the right of the seller to avoid the cost involved in returning unwanted (yet functional) products to the manufacturer.'[165]

But what links all cases where a selling expert has a duty of care to a buying non-expert is where the product can harm him: where the seller, in selling it, would either breach the principle of doing no harm to others, or, perhaps, take a very serious risk of doing so. This applies as much to the stockbroker selling his client a product promising a certain yield and capital security when in fact its structure is such that it is likely to wipe out the client's life savings, as it does to the doctor and surgeon.

It might be asked here, that if a duty of care exists in financial services as much is in medicine, at least in some transactions, how come so many leveraged, risky, complex derivative products were sold to uncomprehending European regional local authorities and banks by Wall Street in the run up to the 2008 financial crisis: and especially, how come so much sub-prime mortgage was lent to the over-borrowed American consumer?

The answer to that is that the regional European banks and local authorities at least purported to be professional. They signed away rights to protection in their transactions with Wall

[165] Ha-Joon Chang, *23 Things They didn't tell you about Capitalism* (2011), London: Allen Lane, p. 5

Street firms on the grounds that they were qualified to do their own analysis and get the better size and price of transaction as a result of being allowed to do so. They held themselves out as experts in expert-expert transactions. Perhaps they deluded themselves, but this is not an exception to the duty of care principle applying when a potentially harmful product is sold, but unfortunate case of the buyer deliberately opting out of protection that was available to non-experts.

The case of sub-prime is an exception, and in many cases was a case of a breach of a duty of care from seller to buyer that the sellers simply did not choose to recognise. What was extraordinary was that the sale of mortgages by mortgage brokers should have been unregulated: in developed countries it is hard to think of any financial transaction that touches the consumer that is not regulated, and yet this exception became a trillion dollar market. Too late, that has changed now: and the underlying moral principle is perhaps quietly recognised in the US government's encouragement of lenders to use some forbearance from foreclosing on these borrowers.

In financial transactions, as with medical ones, there are many layers of relationships. A retail bank may be regarded as having a duty of care when selling a complex insurance product to a customer; a private client manager, an Independent Financial Advisor (IFA), or perhaps a pension fund manager, may be seen to have more of a fiduciary-based duty of care to his client; an investment banker may have neither a fiduciary-based duty, nor a no-harm duty of care to a client who holds himself to be professional and capable of understanding all the risks of a particular product for himself. One needs to take care before generalizing about a duty of care between all 'bankers' and all 'clients': one would not wish, perhaps in denying that a duty of care is owed by an investment banker to a pension fund manager, to be thought to consider that there was no duty of care owed by a retail bank to its ordinary customers. In Section II of the following chapter, whilst I do not argue for a fiduciary-style duty of care between an MFI and its borrowers, I shall argue for a 'no harm' duty of care to exist: and that the requirements of this obligation, which when it goes against the preferences of the borrower will also be paternalistic and as such, a case of required paternalism, are not minor.

Chapter 7 Paternalism (and what passes for it) in the practice of microcredit

I. Application of the Concept of Paternalism to the Practical Rules of Microcredit

(a) The State and Intervention in the interest of borrowers

(i) Usury laws: hard paternalism?

(ii) Interest Rate Caps: impure paternalism?

(b) MFI Rules in the Interests of Borrowers: Soft paternalism?

(i) Compulsory setting of social goals for borrowers

(ii) Training

(c) MFI Rules in the Interests of MFIs: Rules Masquerading as Paternalism?

(i) Weekly/Biweekly meetings

(ii) Compulsory Savings and Insurance

(iii) Loan Use

II. The Dog Not Barking: The Absence of Paternalism Required Under a Duty of Care

<u>I. Application of The Concept of Paternalism to the Practical Rules of Microcredit</u>

(a) The State and Intervention in Borrowing

Most of this section will look at how MFIs' practices relate to their borrowers, and whether or not those practices are paternalistic, or justified paternalism if they are. But there is a long history of a prior question: whether the state may act with justified paternalism in banning lending money at interest at all, or, perhaps, banning the lending of money to certain classes of people and, where it deems it may not, whether it can yet consider using interest rate caps to limit the price at which that money is lent. I shall consider these potential cases of state paternalism in the field of microcredit and whether it can be justified, first.

(i) Usury laws: Hard Paternalism?

Usury originally meant the charging of interest at any rate, and so usury laws that forbade it, at a time when Christian churches banned it, banned any lending that was not simply repaid at the original face value of the loan. The term 'usury' now more commonly means lending of money at exorbitant or illegal rates. The original theological opposition to usury seems not to be paternalistic as such, but based on religious text, and on the nature of what the essence of money is. Aquinas seems to have regarded money as purely a medium of exchange and therefore improper to draw a time value from, as time belongs to no man, but to God. He argued that charging interest was morally wrong as it represented 'double charging': charging both for the thing and the use of a thing. His analogy was that it would be wrong to charge for a bottle of wine and then again for drinking the wine. There was also concern as to the damage to the moral character of the lender the charging of interest might bring: lending should be philanthropic only.

Laws banning usury today (outside of Islam) seldom do so on the basis that it is immoral per se to lend money, but on the basis that the rate is exorbitant, and likely to end up harming the borrower: thus such laws today are generally paternalistic. They are based on the assumption that, overall, borrowing at these rates will do more harm than good to the borrowers. Bentham objected strongly to such laws, sounding very much Mill's predecessor: 'no man of ripe years and of sound mind, acting freely, and with his eyes open, ought to be hindered, with a view to his advantage, from making such a bargain, in the way of obtaining money, as he thinks fit; nor (what is a necessary consequence) anybody hindered from supplying him, upon any terms he thinks proper to accede to.'[166]

If there were clear evidence that borrowing at high rates always does more harm than good to most people, then the case for regarding this as justified paternalism might begin to be made. But, to anticipate the evidence in Chapter 8, there is not clear evidence that this is always true, though that may partly be lack of measurement; and it is certainly equally unclear that it does much good. If it *were* the case that many benefit from borrowing at high rates and only a few are harmed, then banning microfinance for all would be unjustified paternalism – for the ability to borrow to extend or found a business, or to meet some urgent short-term need, or to invest in one's child's education, might very well form a part of the core of how one

[166] Jeremy Bentham, *Defence of Usury* (2008) Dodo Press, p1

conceives of how one wants to live one's own life. It certainly might be a core part of one's hope for a better life.

Of course, the caveat to this – even for Bentham, above – is that the vulnerable – the young, those of unsound mind – should be protected from themselves in the use of borrowing at interest. Here, usury is not banned for all, but for those particularly vulnerable to being harmed by it, and this would be justified paternalism, because we are building into our assumptions a lack of knowledge on the part of the agent as to the risk of the harm he incurs, an autonomy that is not (yet) fully competent.

Wholesale banning of individuals' freedom to borrow (outside, technically at least, of sharia law) is rare today. Advocates of free markets in money lending, based on the contribution this makes overall to innovation and economic growth, and critics of the alternative as unjustified paternalism, have held the day, with the exception of not allowing particularly vulnerable groups to borrow, such as those under 16. What is rather more common than banning credit, is restricting the price that can be charged for that credit: interest rate caps.

(ii) Interest Rate Caps: Impure Paternalism

When a state introduces interest rate caps on the rates at which MFIs or banks lend to borrowers, I shall argue that this is instance of impure paternalism. A state's motivation in introducing an interest rate cap is generally taken to be that it is paternalistically seeking to prevent borrowers borrowing at a rate they will be unable to repay, thus preventing them falling further into debt. A problem for the state is when it knows that some people will be able to borrow at this rate and make successful use of the credit: but does not believe a sufficient majority of potential borrowers are capable of working out where this is for themselves. The state may be right in thinking this: if it has a very poor population constantly on the edge of food insecurity, fear of famine the following year may drive many to borrow at any rate necessary to secure a loan to buy fertiliser or seed.

The state's only way of protecting the majority from rates it regards as too high (other than banning money lending and microfinance altogether), is to impose an interest rate cap for all. It is paternal because it is driven by the government's belief that whilst desperation for credit drives demand for it at these prices and so it, the state, acts against many peoples' will, nonetheless this is the best way to prevent a harm to many. It is soft paternalism for the majority of those protected if the government assumes that their desperation for credit to avoid future hunger has undermined their ability to make a rational decision as to whether borrowing at this rate will not in fact leave them even worse off than they were before. It is hard paternalism if the state believes their desire for credit is formed autonomously, but is simply too optimistic about the prospect of repayment. Could it also be a mixed policy, of soft paternalism towards those who benefit from not being allowed to borrow at rates that it is assumed will harm them, and hard paternalism towards those who would be able to use credit, even at this price, successfully if allowed?

In fact not, because the policy for those who are prevented from borrowing when they could have done so successfully, is not paternalistic at all. To be paternalistic it has to be both for their benefit and in some way an infringement of their autonomy. In this last rationale, the state does not pretend that stopping the few potentially successful borrowers is for their benefit. It is simply that this the cost of having a policy to protect those who it is believed would be harmed. It may or may not be justifiable, but it is not paternalistic. The situation is the inverse of one Feinberg discusses (in response to Dworkin): laws compelling savings towards retirement. As Feinberg puts it, the compulsion on those who do not want to save here, but who are obliged to because the system can only run at all if it has blanket participation (it is assumed that is necessary to generate the economies of scale necessary for it to run efficiently): 'The unwilling are told in effect: "You must participate even if you think it is not in your interest to do so, because it is manifestly in the interests of all the others, and the public interest too, that you do so. The compulsion is for their sakes, not yours."'[167]

Interest rate caps, then, are an example of Dworkin's 'impure paternalism', discussed earlier: paternalism for the majority is sought for their protection and a direct, non-paternalistic imposition made on the remainder, for the sake of the public good. (I state majority, but there is no theoretical reason why this must be a majority/minority situation. We can at least imagine barring a majority from a practice harmless to them, for the sake of the minority it might be very harmful to).

Where imposed for a segment of the population's own good, are interest rate caps a case of justifiable paternalism? They could be, where the justification of partial autonomy is applied

[167] Op. cit. note 138, p. 18

on the grounds that the ability to rationally decide what rate is truly repayable has been undermined by desperation for credit now to avoid future hunger. And there would be at least a case for hard paternalism here if the state thought it impossible such rates could be repaid and the borrower rationally preferred risking the inability to repay to risking the inability to eat in the future. But this case would likely fail the test of the borrower knowing better for himself here than the state is likely to, not justifying the cap. This would be hard to argue if borrowing at very high rates were central to the core autonomy of agents. And here, whilst the goal behind the desire to borrow at these rates – say, to buy fertiliser – is hugely important to the agent and his survival, that doesn't make the method by which he might do so – borrowing at high rates – central to his self-determination.

It is then a further question, even if interest rate caps are found to be justifiable paternalism, whether they actually succeed in their paternalistic intention. It can be argued that all interest rate caps really do is ration credit to the best credit risks, depriving the very poorest of access, who may have the greatest need. For if a lender is restricted in what he may lend at, he will lend only to those who offer him the greatest chance of repayment, and not lend at all to those whose risk of failure to repay is higher. This is so because where he can charge a high rate, some of the profit that comes from doing so will cover the losses that come from the occasional default: where that marginal income from the highest rate is not available, the willingness to take the marginal risk with riskier borrowers disappears.

Thus the impact of interest rate caps can be to restrict the supply of credit, and to restrict it to the very best credits with the lowest risk of default. Paternalistic legislation introduced to protect small borrowers and the poorest can thus have the effect of excluding them from the market altogether. Whether interest rates caps are a case of justified paternalism or not, they can be ineffective, even perverse, in their result.[168]

The state's aim in introducing interest rate caps may be well-motivated, but frustrated in the reality. It might do better if, rather than limiting what a financial institution can lend at to everyone, it limited through regulation those to whom the financial institution can lend at given rates. In other words, it might look to the MFI, via regulation, to achieve its

[168] Results can become even more perverse if interest rate caps are combined with very high inflation, producing negative real interest rates. Armendáriz and Morduch note that in the Philippines, rates were capped at 16% before a reform in 1981, whilst inflation was 20%. 'The negative real interest rates created excess demand for loans, adding pressure to allocate loans to politically favoured residents, rather than to target groups.' Armendáriz, Beatriz and Morduch, Jonathan *The Economics of Microfinance* (2007) Cambridge, Mass; London: MIT Press, p9

paternalistic aims for it. Whether that could be a realistic hope or not can be examined by looking at how paternalistically or otherwise MFIs interact with their clients at present.

(b) MFI Rules in the Interests of Borrowers: Soft paternalism?

(i) Compulsory Setting of Social Goals for Borrowers

Most MFIs emphasise the importance of their social role as well as their financial one. Many stress how women can be empowered by group membership, and this for some is an important claim to make good on in order to attract donor funding. The validity of such claims will be considered in Chapter 9. Here, I simply consider if the requirement by MFIs that clients adopt these social goals is paternalistic.

Grameen, famously, requested all borrowers to learn and practice in their daily lives, the ‘Sixteen Decisions’. (BRAC also has its ‘Seventeen Rules’). Grameen borrowers have to be able to recite the Decisions in order to obtain a loan, so the Decisions were certainly imposed upon them. The 16 Decisions are:

1. The four principles of Grameen Bank - Discipline, Unity, Courage and Hard work – we shall follow in all walks of our lives.

2. Prosperity we shall bring to our families.

3. We shall not live in dilapidated houses. We shall repair our houses and work towards constructing new houses at the earliest.

4. We shall grow vegetables all the year round. We shall eat plenty of them and sell the surplus.

5. During the plantation seasons, we shall plant as many seedlings as possible.

6. We shall plan to keep our families small. We shall minimize our expenditures. We shall look after our health.

7. We shall educate our children and ensure that they can earn to pay for their education.

8. We shall always keep our children and the environment clean.

9. We shall build and use pit-latrines.

10. We shall drink water from tubewells. If it is not available, we shall boil water or use alum.

11. We shall not take any dowry at our sons' weddings, neither shall we give any dowry at our daughters’ wedding. We shall keep our centre free from the curse of dowry. We shall not practice child marriage.

12. We shall not inflict any injustice on anyone, neither shall we allow anyone to do so.

13. For higher income we shall collectively undertake bigger investments.

14. We shall always be ready to help each other. If anyone is in difficulty, we shall all help him.

15. If we come to know of any breach of discipline in any centre, we shall all go there and help restore discipline

16. We shall introduce physical exercise in all our centres. We shall take part in all social activities collectively.[169]

The Sixteen Decisions emphasise discipline, unity of the group, hygiene, and hard work. In a commitment not to give or take dowry, they are quite radical. Rahman[170] and Karim[171] both argue, however, that as Grameen has evolved and grown, the 16 Decisions have become rhetorical. The purpose of the group centres has become wholly one of loan repayment, with recitation of the 16 Decisions now only taking place if there are special visitors, rather than at every meeting as originally required. Rahman notes that whilst Grameen reported in 1994 that there were more than 30,000 dowry-free marriages among Grameen borrowers, there was no evidence of any dowry-free marriages in the village he lived and studied in. On the contrary, 'all Grameen borrowers reported giving dowries for their daughters, accepting them for their sons, or planning to follow the practice in the future.'[172] Indeed, he observes loans that were clearly taken out for the very purpose of paying dowry, regardless of the technical business purpose that the loan was said to be required for.

The Sixteen Decisions were introduced by Grameen as a social development programme, and they do work towards empowerment of borrowers, but they are far short of a womens' rights charter. They are more as Helen Todd describes them,[173] 'a sort of Mrs Beecham's Better Housekeeping for rural Bangladesh.' They cover health, discipline and mutual support, but not (for example) domestic violence, arbitrary divorce, inheritance rights or gender discrimination. 'Its concern is with the women's better functioning as mothers and household managers and so it reinforces the culture of maternal altruism which persuades women to sink their own interests in the good of the family.'[174]

These social development goals would be paternalistic if they are imposed on borrowers. If, however, the borrowers happily sign up to them, there is no lack of voluntariness or infringement to autonomy and so there would be no paternalism. Todd's study draws a

[169] Quoted as Appendix B by Aminur Rahman, *Women and microcredit in Rural Bangladesh* (1999) Boulder, Colorado: Westview p.159
[170] Ibid. p.93
[171] Op. cit. note 131
[172] Op. cit. note 127, p. 93
[173] Helen Todd, *Women at the Center: Grameen Bank Borrowers after one Decade*, (1996) Dhaka: Westview Press, p. 160
[174] Ibid. p223

picture where the Sixteen Decisions are happily embraced by the borrowers, even if not actually practiced. Even with regard to dowry, her study showed that women did regard the practice as an evil, but saw no alternative but to actually practice it.

Todd's study, however, was carried out in 1992, after Grameen had been present in the village she studied for a decade, but before the use of microcredit had exploded very much further in Bangladesh. Even in the first flush of enthusiasm for a new programme, if the borrowers did not agree with one of the Sixteen Decisions, they just ignored them. It was perhaps the case that if a potential borrower could not recite the Sixteen Decisions, she would have disbursement of her loan stopped until she had re-learnt them[175], but there seems little evidence that loans were refused for non-compliance with the Decisions once extended, as the continued use of dowries and slow take-up of pit latrines showed.

Still, to the extent that forcing borrowers to learn the decisions by rote was paternalistic, an argument can be made that the early results of doing so may have justified this. Todd surveyed the weight and height gain of children of Grameen Bank borrowers compared to a control group of non-borrowers, and there was a measureable difference in favour of the Grameen children. Interestingly, as time went on, the health advantage of Grameen borrowers' children against non-borrowers diminished somewhat as good hygiene practices were copied in the village: essentially, if the wider community observed a social practice working, they were happy to follow it too when possible. But in fact even this is not true justified paternalism, for the beneficiaries, the children, are not those who were paternalised, the mothers.

The health and lifestyle Decisions of the 16, then, were either never paternalistic because accepted voluntarily and thus did not impose on autonomy, or did impose on borrowers' autonomy but were not paternalistic because the benefits were for others, or in just a few cases were examples of justified paternalism where the benefit really did go to the borrower herself. This is much less clear of the *financial* Decisions, 13 and 15. It is not obvious that these are in the interests of borrowers, and 15 in particular paved the way for the coercive loan collection practices enforced by fellow borrowers observed in chapter 5. These financial goals, as opposed to social goals, really fit in section (iii) below – rules that present a façade of justifiable paternalism, but are in fact more simply in the interests of the MFI itself.

[175] Todd quotes such a case in op. cit. note 173, p. 22

(ii) Training

Many MFIs require that a borrower have some experience of running a business before a loan will be extended: and even when she has, that she complete training that will cover some basic accounting and management tools for her business. Where the woman is already very experienced, this training may seem paternalistic, but in the majority of cases it will be welcomed by the borrower. The insistence on training is of course just as much for the sake of the MFI as the borrower, in order to try to prevent business failure and loss. Few instances of training will represent pure unjustified paternalism: they will, rather, divide into cases where the training is genuinely wanted, so no compromise of autonomy is involved and no question of paternalism arises: and cases where it is not wanted, but imposed anyway. Where this is only for the sake of the borrower, it is paternalistic, though perhaps justifiably so where the MFI has experience in observing how much worse borrowers do who undertake businesses without this prior training compared to those who do take it. Where the training is for the sake of the MFI itself, to avoid its loss, it ceases to be paternalism as such and just becomes routine imposition on the borrower as a cost of getting the loan. Realistically, it is likely to be a policy with a mixed rationale: in the interests of both borrower and lender alike.

(c) MFI Rules in the Interests of MFIs (Rules Masquerading as Justified Paternalism)

(i) Weekly and Fortnightly meetings

In the original Grameen model and that of BRAC and their replicas, the group of borrowers met weekly: many, now, fortnightly. Sometimes, their doing so is presented by MFIs as empowerment: a rare chance (especially in Muslim countries) for women to travel outside the home compound, to meet other women, exchange tips and gossip. In presenting the frequent group meetings as being required of the women, but for their empowerment, the MFIs suggest that the practice is one of justifiable paternalism. This rather patronising view overlooks the time commitment that has to be made by the borrowers and the fact that, when asked, they generally would prefer to meet less frequently. The reason for the frequent meeting is, in reality, loan disbursement and interest repayment: and the reason the timescale is so frequent is to enable the MFI to stay closely in touch with the progress of borrowers and flag up default risk if a payment is missed. Weekly and biweekly meetings are not paternalistically run as a sort of debtors' Women's Institute: they are for the MFI's benefit of loan collection. The imposition on a woman's autonomy exists: she may judge it worth it in autonomously deciding to take out the loan, and her consent would then validate the practice: but it remains a cost to her of taking the loan, and is not a case of justified paternalism.

It may of course have been the case for some of the older MFIs, and this would be true of Grameen, that when the practice of regular weekly meetings and other practices in this section were begun, that the MFI's rationale for imposing them was mixed, that there was indeed an element of empowerment and protection for the borrower for them as well as the protection of the interest of the MFI. There may have been some justified paternalism initially perhaps. But where the model has been adopted globally *without* any actual empowerment elements – represented by the 16 Decisions or other collective activity raising social issue pertinent to the borrower: or where these practices have since been dropped, as with the 16 Decisions only now being recited when visitors come – then it is clear that the original beneficial intent is essentially no longer present and what remains is mainly the MFI's self-interest.

The reader might then be curious as to why the MFIs keep up the language of these conditions of lending being for empowerment purposes, rather than for loan collection. The answer to that is that these claims are not necessarily made any longer to the borrower, but are necessary for the public perception of the MFI, with the impact that has on its fund-raising. Hence these rules do in some instances masquerade as justified paternalism. No MFI want to be perceived as just an institutionalised moneylender. Rules that impose quite heavily on a borrower's time and resources that are only for the purpose of loan collection could be seen in that way. Appearing paternalistic might not be ideal either, but would be preferred by many MFIs to the alternative.

(ii) Compulsory Savings and Insurance

Most MFIs insist on so-called compulsory 'savings' and some also on the borrower taking out insurance against her death. Again, these are often presented as justified paternalism, encouraging the excellent habit of saving in borrowers for their own good, and encouraging prudence with regard to unexpected death.

In practice, both compulsory savings and insurance are enforced to protect the MFI against the possibility of borrower's default. The way compulsory savings work is that the borrower must deposit a sum, 10% or 20% of the value of the loan, with the MFI before the loan is disbursed. If she does not have this sum, it is deducted from the loan, so that she receives a loan of 80 instead of the requested 100 – although she is still charged full interest on the 100 as if she had received it in full. She does not receive interest on her ‘savings’ (rather, she pays interest on them), nor may she have access to them during the period of her loan (Grameen has changed this practice to allow some access now). The ‘savings’ are pooled with those of all the borrowers in the group borrowing at the same time, and are held by the MFI (this is likely to be book accounting rather than a segregated and protected account).

This pool of savings is then used as collateral by the MFI in the event of a borrower defaulting. Under the group liability model, all the borrowers in the group are jointly liable for the default of any one: but should they be less than forthcoming in making up her repayment, the group’s saving balance will be used first.

It is not obvious what benefit the borrower derives from her ‘savings’, so the claims by MFIs that they are justifiable paternalism helping the borrower develop good financial habits falls flat. The purpose of the savings rules are for the MFI.

This is also clear in the case of compulsory insurance. Todd[176] reports that all Grameen members had to contribute five Taka for every 1,000 Taka received as payment in to an emergency fund which pays out in the event of death or other extreme disaster. She reports that there was one such payment to a Grameen member during the year she spent with two villages in Bangladesh. ‘The husband of one of our GB members, who was himself a member of the male center in Ratnogram, died suddenly. There was a ceremony in which the branch manager handed a letter of condolence and a 5,000 Taka payment from the emergency fund to the widow. Immediately after the ceremony, the bank worker took back the 4,984 Taka that the husband still owed to the Bank, leaving the widow with the letter and 16 Taka.’

The money is supposed to be a grant made to widows/widowers in the face of the death of a member (other uses were approved, but this was by far the most common). What this had become is a grant of 16 Taka and Grameen using the rest to recover its outstanding loan. Rahman[177] observed similar instances in his study of Grameen. Compulsory savings and insurance, then, as commonly defined by MFIs, are not the cases of justifiable paternalism presented, but are just additional ways for the MFI to achieve greater security on its loan.

[176] Op. cit. note 173 p. 26-7
[177] Op. cit. note 127

(iii) Loan Use

Matters become more complex when we consider restrictions the MFI attempts to impose on what the loan is used for. A basic requirement of many MFIs is that the loans are used for productive purposes, not for consumption. Further, because interest payments become due on the loan almost immediately, the enterprise entered into needs to be immediately cash generative. Some then go on to impose further restrictions on the type of loan use: for example, that it only be used for legal activities, or that it explicitly may not be used for activities the MFI considers undesirable. Again, the MFI will claim that these are instances of justifiable paternalism.

Production not consumption

Like training, the insistence that the loan be used for productive, immediately income-generating purposes only – not for investments that produced a delayed or longer term yield, such as agriculture or a child's education, let alone for consumption such as paying for health care or even just food – this insistence would be paternalistic if it were for the borrower's good. But as can be seen from what is not allowed, it is not for the borrower's good per se, but to ensure the MFI begins to be repaid straight away. Investing in land, or fertiliser, or seed, might very well produce a better long term return (and the great prize of food security) than using the capital to set up a tomato-selling business: but a business model that buys wholesale then makes a quick turn by selling retail is strongly encouraged (and different models discouraged) because it is immediately cash generative, and the cash-flow of this model matches the loan repayment requirements of the MFI.[178]

The MFI makes credit available, then, not for any business enterprise, but for enterprises that can repay high interest rates almost at once – the first repayment will be due just a week or two after the loan is disbursed. The borrower may well benefit more from investing in a higher return but poorer immediate cash flow business: the conditions of the loan seek to prevent this. This insistence on loan use for immediately productive purposes only, then, is

[178] I do not mean to suggest here that no MFIs make agricultural loans: some do: but the standard approach is not to encourage borrowing for projects whose payoff is a year away and do not provide a means of servicing the interest in the meantime.

not unjustifiably paternalistic, because it is not paternalistic at all – its aim is not the good of the borrower. Its aim is to maximize the MFI's chances of repayment.[179]

Restricted 'Productive' Uses

Most MFIs make it clear to borrowers that loans may not be used to pursue illegal activities, but where some of these illegal activities meet the cashflow requirements of the MFIs and are widely practised despite their illegality, a blind eye may be turned. An example of this is the use of loans to produce and retail 'moonshine', high ethanol alcohol, in Africa. (This is not known as an issue in Asia.) In this instance, very serious questions of harms to others are then raised, because of the link, especially strong in Africa, between alcohol use and the spread of HIV/Aids, violence and crime. This is particularly so (as with when it is sold by microcredit clients) where it is sold at informal gatherings and from, or from near, private homes.

Kalichman et al[180] in 2007 reviewed all the academic literature – about 80 studies – that examined the link between alcohol use and sexual risk behaviour in southern Africa. They observe that research has 'repeatedly shown that alcohol use is related to sexual risks in several populations, especially among those with the highest rates of HIV infections.'[181] As background, they note that two out of three people with HIV live in sub-Saharan Africa, where great quantities of alcohol are also consumed. They find that: 'Like elsewhere in the world, alcohol use is often associated with sexual risks in southern Africa. However, unlike anywhere else, the implications of alcohol use on risks for HIV infection are greatest in southern Africa because HIV prevalence rates are highest.'[182]

The studies surveyed show clearly that alcohol use is associated with STI and HIV prevalence. The predominant risk behaviour is amongst men who drink, who are more likely to have multiple sex partners, not use a condom, use prostitutes, and then transmit diseases to

[179] In practice, of course, restrictions like this are very hard to enforce. Money being fungible, if a borrower engages in a mix of activities, it will be hard for the lender to ascertain exactly which (production or consumption, or amongst productive) his loan went to support. The lender's inability to fully enforce his policy, however, does not affect the point that the policy, presented as justifiable paternalism, is in fact simply in his own interest.
[180] Seth Kalichman, Leickness Simbayi, Michelle Kaufman, Demetria Cain & Sean Jooste 'Alcohol Use and Sexual Risks for HIV/AIDs in Sub-Saharan Africa: Systematic Review of Empirical Findings', (2007) *Society of Prevention Research* 8 pp. 141-151.
[181] In particular they cite Lance Weinhardt & Michael Carey (2001) 'Does alcohol lead to sexual risk behaviour?' *Annual Review of Sex Research*, 12, pp. 125-157
[182] Op. cit. note 180 p. 141

their partners at home. This is the link WHO refers to when it states: 'Alcohol abuse constitutes one of the principal reasons for the propagation of AIDs especially among married women.'[183] The Kalichman study of studies summarises: 'people who drink alcohol in southern Africa are at higher risk for HIV than individuals who do not drink. The association between drinking and sexual risks is also observed across a wide array of populations. Any alcohol use at all and drinking greater quantities of alcohol are closely associated with HIV transmission risks in southern Africa.'[184]

Having established this, Kalichman et al go on to look at factors that connect to alcohol use that can exacerbate its negative effects. Unfortunately, given this author's experience in seeing the way in which the moonshine produced by women borrowers is sold (at shacks, or from near their homes), the study then finds this to be a distribution method that further increases the risk of spreading disease. 'Informal alcohol serving establishments, such as private homes where alcoholic beverages are sold and served, are also often the same places where sex partners meet.'[185] Research conducted in South Africa has demonstrated the close association between patronizing shebeens and HIV risks. Weir et al[186] mapped the linkages among places where people meet new sex partners and places where people drink alcohol. The study demonstrated a remarkable overlap among these venues; 'over 85% of the locations where people meet sex partners are alcohol serving establishments…As many as 57% of men and 46% of women who drink at shebeens report having two or more sex partners in the past two weeks. Unfortunately, shebeens and other alcohol serving establishments, such as taverns and bottle stores, rarely have condoms available for their customers…The number of days of the week that men drink correlates with their frequency of engaging in unprotected sex with casual partners…Places that serve alcohol therefore appear uniquely linked to HIV transmission risks in southern Africa.'

On top of the risks of HIV-AIDs transmission, Kalichman et al summarise the evidence of a link between alcohol use and sexual coercion. (Note that the highest incidence of new HIV

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[183] Global Status Report on Alcohol (2004), WHO 2004, see at http://www.who-int/substance_abuse/publications/global_status_report_2004_overview.pdf, accessed 11/9/2012
[184] Op. cit. note 180 p.146
[185] Neo Morojele , Millicent Kachieng'a, Matsobane Nkoko, Kgaogelo Moshia, Evodia Mokoko, Charles Parry, Mwansa Nkowane & Shekhar Saxena 'Perceived effects of alcohol use on sexual encounters among adults in South Africa', (2004) *African Journal of Drugs and Alcohol Studies,* 3, 1-20,
[186] Sharon Weir, Charmaine Pailman, Xoli Mahlalela, Nicol Coetzee, Farshid Meidany, Ties Boerma, 'From people to places: Focusing AIDS prevention efforts where it matters most', (2003) *AIDS* 17 pp. 895-903

infections in Malawi is amongst girl adolescents (10-19), 56% of whom report forced sex.)[187] Kalichman et al summarise: ‘Sexual assault is prevalent in southern Africa and sexual violence is related to alcohol use and HIV transmission risks. Men who have a history of sexual violence are more likely to drink than men who have not been sexually assaultive. Likewise, alcohol use is associated with having been sexually assaulted among women…The association between relationship violence and HIV risk is at least partly accounted for by alcohol use...it is clear that alcohol consumption and sexual violence are related’ [188]

The question of whether a woman distilling and selling moonshine in southern Africa does so legally or not varies with each country, but usually turns on whether she has been licensed. In both Zambia and Malawi, for example, the production of moonshine (often called *kachasu* in Zambia, but it has a lot of nicknames in both places) for home consumption, for personal use, is legal. The sale of it, unless licensed, is illegal. The sale of it to under-18s is illegal, whether licensed or unlicensed. (This is a serious problem in Zambia). Some provinces in Zambia have local bye-laws regarding *kachasu* specifically, that make the sale of it illegal even if licensed.[189]

The author has yet to meet a woman borrower in either of these countries who includes the cost of a license in her cost breakdown when asked. It is unlikely that licences are even applied for, as the borrowers are operating in the ‘informal’ sector and do not usually pay taxes. If they are not licensed, then they are selling moonshine illegally. An MFI forbidding the use of a loan for illegal activities may be thinking paternalistically of its borrowers, but as in many other cases may also have mixed motives – its reputation, and possibly its banking licence (where it has one) would be at severe risk if it were found funding illegal activities. The principle that ought to be called upon to justify the prevention of loan use for such illegal activities as the sale of moonshine is much more simple: that of the prevention of harm to others. Perhaps because giving this as a justification might expose MFIs to taking

[187] Anne Conroy, Malcolm Blackie, Alan Whiteside, Justin Malewezi, Jeffrey Sachs, *Poverty, AIDS and Hunger: Breaking the Poverty Trap in Malawi* (2006) Basingstoke: Palgrave MacMillan pp. 59-60

[188] Op. cit. note 180 p. 148

[189] The law in this area in Zambia is summarised by Alan Haworth in *Moonshine Markets*, ed. Alan Haworth and Ronald Simpson, New York: Hove: Brunner-Routledge 2004, chapter 4 pp. 41-67. The main acts are the Liquor Licensing Act (Chapter 167 of the Laws of Zambia), the Traditional Beer Act and the Markets Act, which forbids the sale of alcohol beverages within markets. In Malawi, the main act that covers moonshine is the Liquor Act, 1979. Of course, there is widespread recognition that these laws are widely flouted and rarely enforced, although there are sporadic outburst of activity e.g. a team of 48 security officers rounded up 20 *kachasu* distillers in Mazabuka in August 2009 – though it took them an hour and a half to arrest a woman in her 60s who threatened to bewitch any police officer who dared lift her, see http://www.zambian-economist.com/2009/08/inefficient-policing.html.

responsibility for the indirect consequences of other types of loan as well, this is seldom done.

It is paternalistic: it infringes on the autonomy of MFI clients and the drinkers to prevent the harm to them of potential jail sentences for illegal activities for the clients and catching STIs for the drinkers, and as such is justified paternalism. But more important is the prevention of harm to innocent parties, notably the wives of the drinking men who pass on STIs caught from prostitutes to their partners at home. This prevention of harm is not paternalistic as such (an MFI rule forbidding loans for the purpose of illegal activities imposes on the autonomy of the borrowers, not the autonomy of the wives of the borrowers' drinking clients) but would be justified by the principle of prevention of harm to others.

III. The Dog not Barking: The Absence of Required Paternalism

In our discussion of which of the practices of microcredit are driven by the interests of the borrower, or by the interests of the MFI: and which are paternalistic, and which justifiably so when they are, there has been one resounding absence. At no point have we seen a practice of microcredit institutions that ensures, as far as possible, that the MFI only make loans to people who are, individually, likely to be able to repay them. What such a practice would look like, would be a clear demonstration by the MFI to the borrower of the true interest rate the borrower was going to pay over the life of the loan, and a realistic assessment of the margin and profit the business undertaken by the borrower will generate. Together, these would generate an awareness that, if things go to plan, the enterprise is actually capable of meeting the cash flow requirements of the debt. In other words, the MFI would keep records of the projected cash flow and profitability of the business and the true interest rate being charged on the loan and only extend the loan when the former exceeded the latter.

Having such a policy in place could easily be paternalistic when it resulted in some loan applications being turned down for the good of the borrower, because she was deemed unlikely to be able to repay without having recourse to family, sale of assets or other means that leave her worse off than she was to begin with. This would be an example of the MFI substituting its judgement for another's, the borrower's, to promote the borrower's benefit.

Feinberg's soft paternalism-only approach would be unlikely to find this practice acceptable. One part of it might be – the clarification of the true interest rate the business is going to have to cover – because without this, the borrower will be acting in ignorance, substantially involuntarily, in reaching her decision that she can take on this rate. But beyond this the Feinberg approach will be unable to go.

A broadly consequentialist approach will more easily justify the paternalism involved in declining to extend loans to those very unlikely to be able to repay, but who yet want them. The imposition on the ability to act autonomously by taking the loan is not insignificant, but the harm avoided in terms of the dangers of over-indebtedness may justify this. At the least, a borrower who fails to repay and becomes subject to the coercive pressures of her group, or who has to turn to a still higher rate moneylender to repay her loan, may end up with less autonomy than she began with.

It is worth clarifying why an MFI turning down a potential borrower's request for a loan, when it does so bearing only her and not its interest in mind, would be paternalistic. It might be argued that the decision not to extend a loan does not violate a borrower's autonomy, for the level of the borrower's autonomy would seem to be just the same after the loan refusal as before. But we should bear in mind that it is the usurpation of an agent's decision-making process that is at the heart of paternalism, preventing an agent from doing what he has decided to do. It could be argued that it is just not usually in an agent's gift to decide to take out a loan: she can choose to *apply* for one, and another party preventing her from *applying* would act paternalistically. (As a parent with strong views on the outlook for inflation would, who stopped her student son or daughter from taking out a student loan whose repayment was linked to a future inflation rate.) But the lender merely not approving the loan application would not usually be regarded as paternalistic.

But this is to overlook that in the case of microfinance, the decision to apply for a loan is the same as the decision to take a loan out. The MFI does not have an individual loan approval process. Its requirement is that borrowers form groups, decide amongst themselves who will be allowed to join the group and then guarantee each other's loans. The group then applies together and loans are granted en masse. Thus were the MFI to individuate at this stage, and decide to decline a loan to a borrower for *her* sake, to prevent her running the risk of coercive loan enforcement by her fellow borrowers, then it would indeed act paternalistically (and, perhaps, should.)

Some will be surprised that such fairly simple record keeping as recording the true rate of interest on a loan, the proposed margin on the business of a borrower, or her cash flow, is not already carried out by MFIs in their own interest, to maximize the chances of being repaid, as would be the case if a small business loan were extended in developed countries. But this is to forget that, although the MFI may have been set up with the noble aim of alleviating poverty through the extension of credit, as we have seen earlier, the use of group liability creates perverse incentives for loan officers. Group liability, to recall, means that if one borrower in a group cannot make her repayments, others in the group have to do so for her. This means that the MFI is incentivised, not to ensure that every individual it lends to is capable of repaying her loan through generating a sufficient margin on the business she undertakes, but rather to ensure that there are enough (it need only be one or two) borrowers in the group who are doing so well that they can cover the payments of the struggling borrowers as well. Thus the MFI's purported interest in each individual borrower's ability to repay becomes subverted to an interest that just enough in the group can cover the repayments of all: which may leave some individuals seriously losing out from their microcredit experience, since as we have seen, those losses are not covered by other borrowers without cost to the original borrower.

A practice, then, of MFIs keeping records demonstrating that, at least on the researched, projected business plan, the borrower looks likely to benefit from using microcredit, would be a good practice to implement, even if (justifiably) paternalistic. But is the case stronger than this? Does the lender have a *duty* to the borrower, first, to make transparent the real rate of interest he is charging, and second, to paternalistically refuse to extend the loan if that rate exceeds the margin available from the business she intends to set up?

I would argue to the first that he does: firstly, because if this rate is not transparent, then he misleads the borrower: and secondly, because the extension of credit, especially to the poor, is an application of the principle of a duty of care between expert seller and non-expert buyer when the good provided can be harmful to the purchaser, as laid out in section III of the previous chapter. The borrower's poverty matters here: clearly, an extension of credit to one who would have to sell her last assets, even the roof off her home, if the business failed, has a great deal more potential for having harm done her than the extension of credit to one who would only have to forgo some marginal consumption if the business failed.

On the first point, the true rate of interest charged to the borrower is rarely as transparent as it should be. Typically, a 'flat rate' of interest is charged, quoted monthly: say, 5% per month for a four month loan. A headline rate of 5% will then be quoted, rather than 20% for the four months, or 60% if it were rolled for a year; or 73% if the 20% every four month rate is compounded (i.e. interest is paid on interest.) This is how the rate would have to be quoted in the UK.[190] Indeed, matters are much worse than this: a full calculation of the interest paid, allowing for the capital sum paid off each month, fees etc., could be well over 200%.[191]

There are arguments for not including every step in the interest calculation above for figuring out the true rate of a microcredit loan: the client may not renew it every four months, though they are encouraged to and most do. The point, however, is that the author would have struggled to compute these rates without a scientific calculator, and there are plenty of loan officers and fundraisers in the microcredit industry who simply do not understand the true interest rate they are themselves charging, so one can imagine the difficulty for a compound-interest-calculator-free borrower base to do so. Innocently or otherwise, for an MFI to quote a 5% flat monthly rate, or 60% flat annual rate for its loans when it is actually charging a fully-costed 200% or higher, is grotesque. There are, indeed, some significant margins available to some borrowers finding wholesale suppliers and selling retail. But, perhaps, not all that many exceed these rates. There is a strong case that the MFI who quotes the low rates here and hides the true cost behind a lack of transparency to the borrower, misleads her.

For those who insist that it is caveat emptor, and the frequently illiterate borrowers should be able to work out all this for themselves, we should note that this is not a standard we demand for considerably less vulnerable borrowers in developed countries, where, as noted, in the UK the disclosure of the APR rate is compulsory before any loan agreement is finally signed.[192]

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[190] The standard rate that any UK financial firm must quote in addition to any other rate it uses is the Annualised Percentage Rate (APR) which is 1+({interest rate/100}/number of compounding periods)) raised to the power of number of compounding periods.

[191] The 5% rate will be quoted on a flat-line basis: interest is charged on the full sum initially borrowed in each month, rather than on a declining balance basis, i.e. only on the remaining sum of the loan outstanding (on a four month loan, a quarter of the principal will be paid off each month, as well as the interest due.) A loan of 100 for four months, with 25% paid back each month, is an average balance over the four months of only 62.5, not 100, but interest is charged on the full 100. The 'simple interest' of a flat 20% over four months is 32% on a declining balance basis, which compounds not to the 73% annual rate above, but 229%. Worse is to come. On top of all of this, if 20% of the original loan extended (100) is held back as 'savings', so that the borrower actually only receives 80, but pays interest as if it were 100, then the final annual percentage rate she pays, compounded, on the money actually received, rises to 274%. (Some MFIs also deduct fees from the loan amount before extending it, and most frequency of repayment periods are much shorter than monthly, usually, weekly or biweekly; both factors will raise the true cost of interest still higher. But perhaps enough already.)

[192] As it is in the EU and US, albeit the method of calculating APR is a little different in the US compared to the UK and EU.

But does the MFI have a further duty, not only to provide a fully transparent interest rate, but to keep records to ensure that at least the projected margins of the business the borrower proposes to undertake exceed it? And to refuse to extend a loan unless it does?

In the context of microcredit, despite the seeming contradiction given the importance given here to autonomy, I argue that such a practice – of ensuring projected margins do exceed the interest charged – is required if the extension of microcredit is to be carried out ethically. The risks to the borrower when this is not done are just too great: we are considering indebting the poorest, whose ability to withstand a failure is the least. If one stands back and imagines an MFI that made these calculations and understood which of its borrowers were most likely to fail – and then went ahead and lent to them anyway, because provided it gets repaid by the others in the group, it is in its financial interest to do so – we might more quickly see that what the MFI does here is wrong. If that is conceded, then a requirement not to make that loan when that information is available: and the prior requirement to garner that information, surely follows.

What I am arguing for here is the recognition of a duty of care between the MFI lender and the borrower. To the extent that the exercise of that duty of care (when refusing loans to those wanting them but very likely to have to struggle hard to repay them without severe sacrifice) is paternalistic, that is not only justified by the harm avoided, but the duty of care requires it. We saw in section III in the previous chapter that a duty of care between seller/provider of a good and its purchaser exists when the product is potentially harmful and the purchaser's ability to assess its appropriateness for herself is foreseeably impaired (whether through her relative ignorance, or the product being sold in such a way as to prevent this).

The application of this to microfinance would be as follows. A loan carrying an interest charge, especially a very high one, is a potentially dangerous product for the borrower. It may facilitate some profitable transaction whose profit margin more than covers the interest rate cost: but as we have seen in previous chapters, it may also lead the borrower into a downward spiral of debt from which she cannot extricate herself, which in the poverty-ridden world of microfinance, may see her bullied, coerced and even driven to suicide. The product of debt is, clearly, potentially dangerous, as with Stevenson's snail-infested ginger beer. There is also the required limitation on the borrower's ability to assess if the product is suitable for her or not: the woeful lack of transparency as to the true interest rate on most microfinance loans operates like the darkened glass on the ginger beer. Without knowing the true rate, the borrower cannot properly assess if the product is suitable for her, if the true cost of the loan exceeds the margin she can make using the loan, or if her cashflow from other sources of income can make up the loan repayments. Finally there will be occasions where the borrower demands the loan despite these problems, and exercising the duty of care then is paternalistic, but not only justifiably so, but is required of the MFI.

A duty of care in lending has not, hitherto, been clearly established. That may partly have been because in the past, a financial institution may often have acted in the same way as it would have done had one been recognised, from its own self-interest in maximising the chances of getting the loan repaid. In developed countries, analysis of a borrower's cash flow or business prospects for a business loan is standard practice before extending a loan: not from paternalistic motives of preventing over-indebtedness in the borrower, but to protect the profitability of the financial institution, which would suffer severely if more than a few are unable to repay loans. A duty of care may always have existed, but been subsumed from our notice by the institution's own self-interest in acting in the same way as if it had been. It has been the advance of securitisation in developed markets, and the group liability model in microfinance, that has divorced the interest of the lending institution from that of the borrower with regard to repayment. In the US housing market, once the original, long-practiced 'originate-to-hold' method of making housing loans (old-fashioned savings and loans and banks making mortgage loans directly to known clients of the institution and then holding them until repaid many years later) gave way to the 'originate-to-distribute' methodology that securitisation made possible in the 90s and 00s. Once that occurred, the commonality of repayment interest between borrower and lender ceased to hold, and the sub-prime mortgage crisis of the mid 2000s became possible. In the world of microfinance, as we have seen, the group liability model means that the lender does not require that any particular borrower be able to repay her loan, only that some or all of the group are capable of doing so on her behalf if she fails to.

So the old-fashioned prudence in lending, which masked and made unnecessary a duty of care to the poorest borrowers (who are more vulnerable to harm in the event of failure to repay), ceased to be applied. But that, of course, hardly means that the moral duty of care ceased to apply. Rather, that duty now needs enunciating since changes in financial practice have left its assumed absence exposed. But if we accept a duty of care in construction, in medicine – in, in fact, the manufacture and sale of all products – there is no reason not to accept it in lending as well, just because we once had no apparent need to. It was always there: it was subsumed by good practice: and it now stands clear again in times of bad practice.[193]

And does a duty of care imply a limited, but required, paternalism? In medicine we think so. Where the product is potentially harmful and the patient unable to assess its advantages and disadvantages to him, but believes he wants it, we expect the doctor to override the patient's autonomy and refuse to prescribe where he believes it will do more harm than good. Ditto financial services: the borrower may want a loan, but if considering his business prospects or overall cashflow, the lender perceives it to be more likely to harm than benefit him (even though not necessarily harm the lender where group liability exists), then the lender has a duty to the borrower, paternalistically, not to make that loan. The harm principle requires it.

To summarise this and the preceding chapter, then, paternalism is prima facie wrongful, but may be justifiable where either autonomy is partial, or the imposition on autonomy is trivial, and the benefit accruing to/harm avoided by the subject of the paternalism great. In the practices of microcredit, most state intervention in the sector through banning it, or through the use of interest rate caps, is judged to be unjustifiable paternalism, or simply just ineffective. With regard to the practices of microcredit lenders themselves, a case was found for viewing the paternalistic imposition of social goals and financial training on borrowers as justifiable: but the imposition of many standard practices often presented as justified paternalism – weekly meetings, compulsory savings and insurance, the use of loans for productive purposes only – were not found to be justifiable paternalism at all, as not even being paternalistic, but simply in the interest of the lender. Some practices of banning particular types of loan use were found not to be paternalistic, but justified by the prevention of harm to others.

[193] There are other reasons why a duty of care in finance is harder to establish legally (as opposed to morally). Peter Cane notes in his entry 'Negligence in Civil Law' in '*The New Oxford Companion to Law*' (2008) Oxford: Oxford University Press p. 828) that 'foreseeability is normally a sufficient condition of the existence of a duty to take care not to harm another's body or physical property (cars, houses, and so on); but it may not be sufficient in relation to mental harm or financial loss. This is partly because it is considered not as important for the law to protect people from mental harm and financial loss as from bodily injury and property damage.' But of course, the fact that a duty of care is harder to establish in the case of financial loss than in the case of physical loss does not mean it cannot be established at all: especially where here, in microfinance, the group liability structure for repayment means that it is foreseeable to the MFI that a financial loss may easily translate into physical loss (to person or property) as the group tries to recover what it can.

Most challengingly, it has been argued that there is a duty of care on microcredit lenders to their borrowers which, in some instances, not only justifies but *requires* paternalism in the form of refusing to extend loans to those demanding them who are very unlikely to be able to repay them, and who may incur great harm when others covering their missed payment exert potentially severe coercive pressure on them. This application of a duty of care is held to hold in microfinance as it does in other areas where a product is potentially harmful and the purchaser's ability to judge its suitability for himself is foreseeably impaired, but he yet still desires it. Of course, that duty of care may go beyond microcredit to the provision of financial services generally where lending to the poorest (and thus most vulnerable to harm if unable to repay) and where the rate lent at is equally obscure, be that subprime or payday lending. But its application to microcredit is all I seek to establish here.

Chapter 8: Does Microfinance Work Towards Alleviating Poverty?

Throughout this thesis, we have seen that, on occasion, microfinance institutions exploit and coerce their borrowers, claim to justifiably paternalise when simply following their own interest and fail to paternalise where it might be thought a duty of care was owed by the microfinance institution to the borrower in particular instances to do so. Throughout this thesis, the question has had to keep being deferred: all these things could yet be worth it (at least for a consequentialist) if microfinance succeeds in its claims of empowering and raising its borrowers out of poverty. The next two chapters finally address that issue. Does microfinance succeed in making good on its claims? This chapter examines the evidence at the micro and macro level that microfinance reduces poverty, Chapter 9 whether it empowers its borrowers.

The claims of poverty reduction and empowerment that the industry has made have been large. Leading MFIs would advertise themselves as offering a solution to global poverty. One of the strongest claims came from Muhammad Yunus: '58% of the poor who borrowed from Grameen are now out of poverty. There are over 100 million people now involved in microcredit schemes. At the rate we're heading, we'll halve total poverty by 2015. We'll create a poverty museum in 2030.' [194]

Claims for empowerment have hardly been less demanding. ACCION, FINCA, The Grameen Foundation, Opportunity International, Unitus and Women's World Banking, all leading players in global microfinance, put out a common statement[195] in September 2010 stating that 'microfinance is particularly able to empower women, giving them access to the material, human and social resources necessary to make strategic choices in their lives: establishing or strengthening financial independence; transforming power relationships; improving stability and family prospects by directing more income towards families; and, particularly, engendering dignity and pride.'

Whilst less certain of itself today, the hype promoting microfinance is still active: on January 27, 2011, the Microcredit Summit Campaign issued a press release beginning: 'Nearly 2 million Bangladeshi households involved in microfinance – including almost 10 million family members, net – rose above the US$1.25 a day threshold between 1990 and 2008.' The

[194] Interview with Ishaan Tharoor, Time Magazine 'Paving the Way out of Poverty', Oct 13 2006, available at www.time.com/time/world/article/0,8599,1546100,00.html

[195] 'Measuring The Impact of Microfinance: Our Perspective' available on each of their websites, for example at http://www.accion.org/Document.Doc?id=794

report does go on to say that there is no proof of causality here, but the bold linking of the numbers moving out of poverty with the numbers receiving microfinance is evidently intended to be suggestive.

This chapter examines the evidence for poverty alleviation. In Section I, the problem of what is to count as evidence is examined: until recently, there had been no randomised control trials (RCTs) of microfinance, and there are problems of methodological weaknesses in the anecdotal, before-and-after and 'impact' studies that we had, most especially their lack of measuring drop-outs from microfinance programs. We do now have a few RCTs, however, and these will be examined in Section II – and the absence of much positive evidence that microfinance does lift its borrowers out of poverty observed.

The examination of the evidence of the impact of microfinance thus far will have been at the micro level: the impact on microfinance's borrowers. If we are looking at the overall impact of microfinance in terms of numbers net raised out of poverty, we should not, perhaps, just be looking at MFIs' own borrowers. We should also consider the impact on non-borrowers: if microfinance brought about growth and its borrowers then started employing others in their community as their business grew, the overall impact of microfinance on its community could still be positive, even if it was only marginal at best for the microentrepeneurs. In Section III, these issues are considered: unfortunately, the evidence (such as it is) is the other way: it can be argued that the displacement effects of microfinance just reduce margins for all and drives others out of business. There is little evidence of microfinance businesses growing and providing employment other than for the self-employed borrower. There is also potentially a high opportunity cost here if subsidy that has gone in to microfinance could instead have gone in to developing a country's small and medium enterprise (SME) sector that might actually have increased productivity and created growth, thus ultimately reducing poverty, but this is hard to measure.

In the process of examining all this evidence, and establishing what we do know about the net overall impact of microfinance, we also learn how little we know about the distribution of returns from microfinance to its borrowers. Concluding that there is net zero impact, after all, is not at all the same as concluding that there is no impact: we still need to know how many are made worse off (and by how much) and how many are made better off (and by how much.) For every one that does escape from poverty, how many (if any) fall back in to a more extreme form of it? There is some evidence that the very poorest do the worst from microfinance, and that some of the industry's well-meaning attempts to extend it to them, are badly misplaced and backfire. The philosophical stance one takes towards questions of distribution of benefits and harms – whether all count equally, whether some form of priority should apply, whether large harms cannot be justified by offsetting even larger gains – will thus affect whether one thus sees microfinance as 'working' or not. These problems are discussed in Chapter 10, after Chapter 9 explicitly considers the issue of empowerment.

I. What Counts as Evidence

Over the past thirty years, there have been many studies by microfinanciers and academics to demonstrate the positive impact of microfinance: but the vast majority have been beset with methodological flaws that have rendered their findings of little applicability to the question of the overall impact of microfinance. In a recent systematic review of publications on the impact of microfinance,[196] Durendock et al surveyed 2643 publications, but found only 58 worth studying in depth, observing 'our report shows that almost all impact evaluations of microfinance suffer from weak methodologies and inadequate data…thus the reliability of impact estimates are adversely affected.'

Beyond the fundraising and marketing story-telling, where an MFI selects a borrower with a particularly moving story to tell of how access to credit has transformed her life (with no counterfactuals or suggestion of representativeness), the early studies of microfinance were 'before-and-after' studies, which compared a group of borrowers on various measures of health, childrens' education and income at the onset of taking out a microloan, and then a year or some years later. The problem with these studies is that although they can give a rich detail of a borrower's life, there is no counterfactual – there is no control group of similarly-placed non-borrowers against which to begin to judge whether any improvements seen were simply due to growth in the local economy, or changed governmental welfare distribution policies, rather than the microloan. Worst of all, 'drop-outs' are seldom included in these studies. Thus Helen Todd's study of Grameen borrowers, discussed earlier[197], studies only borrowers of many years standing, and does not look at how life fared for those who took loans, ceased repayment and left the group. Todd's insights into group dynamics remain very

[196] Maren Duvendock, Richard Palmer-Jones, James Copestake, Lee Hooper, Yoon Loke, Nitya Rao, 'What is the Evidence of the Impact of Microfinance on the well-being of Poor People?' (2011) London: EPPI-Centre, Social Science Research Unit, Institute of Education, University of London
[197] Op. cit. note 173

helpful, but as an assessment of net positive impact of credit on borrowers (which she observes) the study tells us nothing, as any negative impact on those ceasing borrowing is not measured. With regard to how far the loan can be measured as the cause of any impact, in a recent study using data from a microfinance programme in Nepal, Rajbanski, Huang and Wydick[198] find that 'just over two thirds (68.3%) of the significant apparent impact observed by practitioners based on 'before-and-after observations of microfinance borrowers is illusory.'

It is not surprising, perhaps, that not measuring impacts on drop outs seriously skews results; after all, if it is largely unsuccessful clients who drop out, not measuring them amounts to simply not measuring one's failures and only measuring one's successes. Alexander-Tedeschi and Karlan[199] also found that failing to include dropouts biases estimates of impact. Criticising the Assessing the Impact of Microenterprise Services (AIMS) methodology used by USAID to asses impact (which recommends excluding programme dropouts in calculations), they find that including dropouts changes the measures of impact dramatically: 'Where the AIMS cross-sectional methodology showed an increase of US $1200 in annual microenterprise profit, including dropouts caused the estimate to fall to a decrease of about $170.'

Most of the 2643 studies Dupendock et al discount are more sophisticated than before and after studies; they are 'impact studies' that do use a control group to attempt to measure the counterfactual, although many still have a problem with not tracing dropouts from the target group. There have also been other problems associated with these too, as Mosley lays out in his working paper 'The use of control groups in impact assessments for microfinance.'[200] The main biases that can enter impact studies using control groups are sample selection bias, misspecification of underlying causal relationships, and motivational problems. Sample selection bias is perhaps the most major of these.

Mosley notes that there is a significant risk that the comparison between the control group and the target group may become contaminated by factors that prevent the control group effectively simulating the without-project situation. The target group – the borrowers – may

[198] Ram Rajbanski, Meng Huang and Bruce Wydick 'Measuring Microfinance: - Cognitive and Experimental Bias – with new Evidence from Nepal' (2012) Working Paper

[199] Gwendolyn Alexander-Tedeschi and Dean Karlan 'Microfinance Impact: Bias from Drop-Outs' (2006) Financial Access Initiative and Innovations For Poverty Action, see www.financialaccess.org

[200] Paul Mosley 'The use of control groups in impact assessments for microfinance' (1998) Working Paper no. 19, International Labour Office, Geneva

possess qualities the control group does not have, such as an entrepreneurial ability that drives them to become borrowers in the first place: but it is then impossible to say if any subsequent success is due to the loan, or their more driven approach. Mosley also notes Roethlisberger and Dickson's[201] observation of 'Hawthorne effects', where factory workers who knew themselves to be the subject of an experiment simply become more productive than those workers not singled out as such. Sample bias can also occur because, being fungible, a loan is not used for the purpose intended: Goetz and Gupta[202] showed that the proceeds of some loans awarded to women were simply passed through and used by men who were not necessarily in the target group against whom impact was being measured, meaning that here, potential impact – positive or negative – of a loan was simply not being recorded. Sample bias can also enter by the control group becoming contaminated by outside events – unless the MFI extending loans to the target group is and remains the only MFI in the area, members of the control group may over the course of the study get loans from elsewhere, thus invalidating the impact of a microloan study.

As Armendáriz and Morduch[203] observe 'this is not an esoteric concern that practitioners and policymakers can safely ignore. It is not just a difference between obtaining 'very good' estimates of impacts versus 'perfect' estimates – the biases can be large.' Armendáriz and Morduch quote McKernan's[204] study of Grameen Bank, which 'finds that not controlling for selection bias can lead to overestimation of the effect of participation on profits by as much as 100 per cent. In other cases discussed later, controlling for biases reverses conclusions about impacts entirely.'

Careful construction of target and control groups can reduce some of these issues. Where an MFI is starting up, has no competitors in town, and is rolling out its program, it can use as a control group for new borrowers those identified as borrowers-in-waiting (those who want to borrow, perhaps in a year's time when funds to the MFI became available). Hidden factors such as entrepreneurial ability can also be controlled for. The number of studies reaching this criteria is of course much fewer than the whole: and amongst these, the problem of tracing

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[201] Fritz Roethlisberger and William Dickson, *Management and the Worker* (1939) Cambridge Mass: Harvard University Press

[202] Anne Marie Goetz and Rina Sen Gupta, 'Who Takes the Credit? Gender, power and control over loan use in rural credit programs in Bangladesh' (1996) *World Development* no 24 pp. 45-63

[203] Beatriz Armendáriz and Jonathan Morduch *The Economics of Microfinance* (2007) Cambridge. Mass.; London: MIT Press p. 201

[204] Signe-Mary McKernan 'The Impact of Microcredit programs on self-employment profits: Do non-credit program aspects matter?' (2002) *Review of Economics and Statistics* 84 (1) pp. 93-115

and measuring impact on those who drop out of the program remains, and is a large issue. Graham Wright[205] finds dropout rates as high as 25-60 per cent per year in East Africa, and Hulme and Mosley found dropout rates of 15% in Bangladesh.[206]

In 1998 Pitt and Khandler[207] published a study that promised to get beyond the problems of before and after studies and impact studies using control groups by taking a quasi-experimental approach. This became the most influential study of microcredit's impact until the very recent development of randomised control trials. It studied 1798 households who were members and non-members of three Bangladeshi MFIs, Grameen Bank, BRAC and RD-12. This used the fact that all three MFIs limited membership to those who had less than half an acre of land, with the idea that there was actually little difference in the poverty level of those just below and just above the half acre cut-off point, so this could be used to measure the difference between those in poverty receiving a microloan and those in similar poverty not doing so in otherwise extremely similar circumstances. Pitt and Khandker's principle finding was that 100 taka lent to a female borrower increased household consumption by 18 taka (increases in household consumption when the loan was made to a male were lower.) However, its own soundness was challenged by Morduch[208] and later also Roodman and Morduch[209], in an academic debate that had econometricians gripped and non-mathematicians struggling to keep up[210]. Eventually, Pitt made his own computer code available to Roodman and Morduch: their running of this did cancel the negative result they had originally found instead of Pitt & Khandker's positive one, but still left Roodman concluding: 'the bottom line is the same: these studies can show correlations but cannot credibly prove causation.'[211]

What this section has done, then, is to explain the methodological weaknesses of the vast majority of impact studies carried out in microfinance up until the last few years. In the last

[205] Graham Wright 'Dropouts and graduates: Lessons from Bangladesh' (2001) *Microbanking Bulletin* 6 pp14-16

[206] David Hulme and Paul Mosley, *Finance Against Poverty: Effective Institutions for Lending to Small Farmers and Microenterprises in Developing Countries* (1996) London: Routledge

[207] Mark Pitt and Shahidur Khandker 'The Impact of Group-Based Credit Programs on Poor Households in Bangladesh: Does the Gender of Participants Matter?' (1998) *The Journal of Political Economy* 106 (5) pp. 958-996

[208] Jonathan Morduch 'The Role of Subsidies in Microfinance: Evidence from Grameen bank', (1999) *Journal of Development Economics* 60 (1) pp. 229-248

[209] David Roodman and Jonathan Morduch 'The Impact of Microcredit on the Poor in Bangladesh: Revisiting the Evidence', Working Paper 174, Centre for Global Development

[210] The mathematical technique employed by the original Pitt & Khandker study is called the 'Weighted Exogenous Sampling Maximum-Likelihood-Limited Information Maximum Likelihood-Fixed Effects.'

[211] David Roodman, *Due Diligence: An Impertinent Inquiry into Microfinance* (2011) Washington D.C.: Center for Global Development p.165

few years, a very few genuine randomised control studies, the recognised gold standard for studies in medicine, have been carried out in microfinance. The next section examines them, and uses them as the basis for concluding that there is no clear evidence of impact of microcredit on borrowers. It is, admittedly, a very slim number of studies on which to do so: but it is perhaps better to rely on a methodologically sound few, than the methodologically flawed many.[212]

II. Randomised Control Trials: Evidence for the Micro Impact of Microcredit on Borrowers

As of April 2012, there are now nine RCTs published altogether, six examining the impact of microcredit, and three the impact of microsavings. RCTs are widely used in medical trials (especially drug trials) because, unlike qualitative studies and quantitative quasi-experiments such as that of Pitt and Khandker discussed above, they can prove causality. Of course, they have their weaknesses too: they may only provide a limited understanding of context and process. And depending on the method of randomization, they may or may not capture the effects of microfinance on others in the community who do not take it up. But for the question at issue here – the impact of the provision of microcredit on levels of poverty – they are largely what we do want. All the studies are important, but the largest and most resonant was the 'Spandata' study, which was carried out in the heart of Indian microcredit, Hyderabad in Andhra Pradesh.

The Spandata[213] study was the first randomised evaluation of the impact of introducing microcredit in a new market. Spandata, a fast-growing MFI, was expanding in to Hyderabad and chose 104 areas of the city as it planned new target markets. It then randomly chose 52 of these to begin lending in to in 2006 and 2007. All 104 districts (6,000 households) were then surveyed around eighteen months after lending had begun. In the areas Spandata had targeted, twenty seven per cent of households took a microloan, two-thirds from Spandata: in

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[212] In this, I follow the argument laid out by Roodman in *Due Diligence: An Impertinent Inquiry into Microfinance*. This argument – that we can only really rely on RCTs, not flawed impact studies for judging the overall impact of microfinance on poverty levels (impact studies may have roles at a finer grained level) – is criticised for setting the methodological barrier too high and that (as Roodman asks himself) how can 150 milllion women asking for microcredit all be wrong? But easy as it is to become emotive in the face of borrowers demanding loans, 150m requests for a loan says much about the need for financial services, even on the terms at which microcredit is offered, but says nothing about whether at the end of the day the loans alleviate, do nothing for, or exacerbate their poverty.

[213] Abhijit Banerjee, Esther Duflo, Rachel Glennerster and Cynthia Kinnan, 'The Miracle of Microfinance? Evidence from a Randomized Evaluation' (2009) Massachusetts Institute of Technology, Department of Economics

the control areas this was just under nineteen per cent (obviously, none from Spandata.) The difference in usage of microcredit overall between the two groups was the basis for assessing the impact of microcredit. The fact that both groups were so large should mean that any biases arising would be present in both control and target groups in equal measure: all shared the same slum background, and an approximate US $3 a day to live on.

Banerjee et al summarise their results as follows: 'Fifteen to eighteen months after lending began in treated areas, there was no effect of access to microcredit on average monthly expenditure per capita, but expenditure on durable goods increased in treated areas and the number of new businesses increased by one third.'[214]No impact on average consumption was found, then: or, for that matter, on the empowerment issues the subject of chapter 10: 'We find no impact on measures of health, education or women's decision-making.'[215] What they did find was an increase in the purchase of durables, especially business durables. The loans seem to have been used largely for capital investment in existing small-scale businesses. This has not, in the time frame measured, fed through either positively or negatively to the poverty levels of those who received the loans. One possibility is that the time needed for a return on capital is simply longer (although this would be a stronger argument if the capital investment was into wholly new businesses that needed time to get established: as they were in to existing businesses, looking for a clear return within eighteen months seems not unreasonable.) It may be that measuring again after two or three years would show clearer impacts on poverty one way or the other, but unfortunately we may never know. A second survey was reported as planned for late 2009 – early 2010, but through the period of Bannerjee et al's study, an enormous bubble in the provision of microcredit in Andhar Pradesh developed, with many providers and multiple loans becoming available to borrowers, such that the control group would have been seriously contaminated. The bubble burst in 2010, with widespread over-indebtedness, mass default, possibly hundreds of borrower suicides, some of which will have been related to inability to repay, and the future of the microfinance industry in India at stake.

These developments have nothing to do with this study, however. The findings of the study are simply that where there was an existing business, loans were used to expand it: where there was not a pre-existing business, loans were used to increase nondurable consumption (food, or possibly paying down more expensive debt.) As the authors suggest, the different

[214] Ibid. p. 1
[215] Ibid. p. 1

uses for the loan make the long run impact of the programme hard to assess. 'For example, it is possible that in the longer run those people who are currently cutting back on consumption to enable greater investment will become significantly richer and increase their consumption. On the other hand, the segment of the population that increased its consumption when it got the loan without starting a business may eventually become poorer because it is borrowing against its future, though it is also possible that they are just enjoying the "income effect" of having paid down their debt to the money-lender (in which case they are richer now and perhaps will continue to be richer in the future.'[216] Overall, on the substantial evidence it gathered then, the study found no clear impact of the provision of microcredit on poverty. Given the size and methodological solidity of this study, and the fact that it was aimed at the profile of borrower who many have most sought to help, this was a sadly disappointing outcome for the proponents of microcredit.

The second significant study published in 2009 was a randomized study of microfinance carried out in South Africa in 2005 by Karlan and Zinman.[217] The group they observed was very different from the classic 'Grameen' type of borrower of the Spandata study. Karlan and Zinman asked a South African lender to relax its risk assessment criteria by encouraging its loan officers to approve randomly selected applications for credit which had previously been marginally rejected. With a starting sample of 3,000 loan applicants, half were originally rejected as uncreditworthy by the lender, and half accepted. Of the half rejected, these were split between those who failed the credit scoring by some distance, and those who did so only marginally. The 750 marginal rejections were then randomly split and half accepted and became the target group for the impact of microcredit: the other half were the control group. Two years later, both groups were re-measured for the impact. Note this study randomises the individuals chosen in to target/control group: the Spandata study randomised by slum. That means the Spandata study includes any 'spillover' effects of microfinance in the whole community, borrower and non-borrower alike: the Kinman and Zinman studies do not.

The target and loan group had incomes of around US$ 6.50 a day: this is not a group as poor as that of the Spandata study (all figures are PPP adjusted). Nor were the loans to be used to set up businesses: they were consumer loans with no restrictions on loan use. They were very expensive loans: around a real rate of 200% APR. Frequently, the borrower was in some form

[216] Ibid. p. 21
[217] Dean Karlan and Jonathan Zinman 'Expanding Credit Access: Using Randomized Supply Decisions to Estimate the Impacts' (2009) *Review of Financial Studies* 23 (1) pp. 433-64

of employment already: these loans operated very much like pay-day loans in the US and UK.

Karlan and Zinman found that the increased access to credit, even at these rates, improved average outcomes. Over the 6 to 12 month horizon, those in the treatment group were 11% more likely to retain their job, and their incomes were significantly higher.[218] Treated households were also less likely to experience hunger, and had more positive outlooks on their prospects and position. Karlan and Zinman did also find significant and negative impact in terms of borrowers suffering increased depression and stress. But the overall conclusion was definitively positive, despite the number of factors conventionally thought likely to make it negative – the lender being for-profit, the sheer cost of the credit and the loans being for consumption not production.

The key finding of this study, then, was that a microloan somehow helped borrowers keep their jobs, which had a knock-on positive impact on their level of poverty, compared to those who had not had access to a loan – even at these rates. This is not direct proof that microcredit alleviates poverty – it is staying in steady employment that is doing that here – but that the loan is somehow facilitating the keeping of that job. It is acting as a shock absorber to prevent something that might otherwise cause a borrower to lose his job, or not get another one if he has lost it. The importance of access to finance as a shock absorber will be discussed in more detail in the following chapter, but Karlan suggests that how this might have worked is that loans may have been used to 'buy required uniforms, or sample sets for sales work, or fix and buy a vehicle to get to the job.'[219]

If the Spandata study showed no impact of microcredit in reducing poverty then, the Karlan and Zinman study showed a significant, but indirect impact – in enabling borrowers to keep or renew jobs, more got above the poverty line. This was an encouraging outcome, if not the type of group most microcredit has classically been aimed at.

Karlan and Zinman repeated the structure of this study with a study in Manila with First Macro Bank, where 1601 individuals were randomly 'unrejected', using the same methodology as in South Africa. Re-measured after between eleven and twenty-two months, however, it was found that 'the number of business activities and employees in the treatment

[218] They were 7% more likely to be above the poverty line than the control group.
[219] As reported by Roodman in *Due Diligence*, op. cit. note 203 p. 166, quoting an email from Karlan to himself, July 23 2009

group decreased relative to controls, and subjective well-being declined slightly. However, we did find that microloans increase ability to deal with risk, strengthen community ties, and increase access to informal capital. Thus, microcredit here may work, but through channels different from those often hypothesized by its proponents.'[220]

The subjects of this study were not largely already employed, as in South Africa, but small scale entrepreneurs running small businesses such as corner shops, and on an average income of around US$ 8 a day (PPP-adjusted as before: so, again, well above the poverty levels of the Spandata study.)

What Karlan and Zinman found particularly surprising in the results of this study was less that the subjective well-being did not improve, but that those randomly receiving loans in fact shrank their businesses. They observe: 'Our findings add to a very muddled picture on the impacts (or lack thereof) of microcredit.'[221] They conclude that: 'the theory and practice of microcredit remain far ahead of the evidentiary base needed to make good policy and to improve the delivery of financial intermediation. Our findings here are surprising and provocative: microcredit in this context does not generate bigger businesses, higher income and subjective well-being, but rather led to stronger risk management, fewer businesses and lower subjective well-being. The current literature, and popular rhetoric from policymakers and microcredit institutions, puts forward a relatively simple story about microcredit working through business investment and female empowerment. In contrast, our findings suggest that microcredit works through more complex and disparate mechanisms that start with the household rather than the business.'[222]

Three more RCTs have since been carried out, in Morocco,[223] Mongolia,[224] and Bosnia.[225] These varied from Banerjee et al's Spandata study in not being carried out in densely populated urban areas, and the precise method of randomisation used. But overall conclusions were consistent. Where there was an existing business, the loan was used to put more money

[220] Dean Karlan and Jonathan Zinman, 'Microcredit in Theory and Practice: Using Randomized Credit Scoring for Impact Evaluation', (2011) *Science* vol. 332 p. 1278-84
[221] Ibid. p. 1282
[222] Ibid. p. 1283
[223] Bruno Crepon, Florencia Devoto, Esther Duflo and William Priente, 'Impact of Microcredit in Rural areas of Morocco: Evidence from a Randomized Evaluation' (2011), Massachusetts Institute of Technology
[224] Orazio Attanasio, Britta Augsburg, Ralph de Haas, Emla Fitzsimmons, Heike Harmgart, 'Group Lending or Individual Lending? Evidence from a Randomised Field Experiment in Mongolia', (2011) European Bank for Reconstruction and Development Working Paper no. 136
[225]Britta Augsburg, Ralph de Haas, Heike Harmgart, Costas Meghir, 'Microfinance at the Margin: Experimental Evidence from Bosnia and Herzegovina' (2012) , Working Paper January 2012

in to it, but after two years there was little or no effect on average consumption, health or education, or indeed on female empowerment where this was measured. The Mongolian study saw a small, positive increase in the proportion of borrowers' children going to school: but the opposite effect was found in the Bosnian study, where teenage (16-19) children of borrowers were 19% less likely to attend school than those in the control group. The only clear conclusions from these studies were that microcredit facilitated an increase in business investment and activity: but not necessarily a profitable one, nor one that had an impact in reducing borrowers' poverty.

To summarise, then, of these five RCTs examining the impact of microcredit on poverty, four find no positive impact, and the fifth, Karlan & Zinman's study in South Africa, does find a positive impact but not through the classic lending to very poor microentrepeneurs, but through the mechanism of payday loans to the less poor working in the formal sector, which enabled them to hang on to, or find, jobs.

There have now also been three studies published that look at the impact of providing microsavings as opposed to microcredit.[226] In Dupas and Robinson's study in Kenya, free savings accounts were offered to existing small scale microentrepeneurs. The accounts paid no interest, and charged for withdrawls, but offered a safe place to save and with the withdrawl charge, a discipline to encourage saving. Note that the take-up of the savings accounts offered was 87%, in contrast to the 27% and 16% take-up rates in the Spandata and Morocco RCTs quoted earlier.

Over the following six months, there were significant differences between female (who were mostly market vendors) and male savers (who were mostly bicycle-taxi drivers.) The market women used their bank accounts quite actively, and increased their savings. The men used the accounts less and did not increase savings. Women invested more in their businesses and increased both personal spending and spending on food. Unlike the RCTs for credit, where results are mixed at best, there was a clear increase in savings for women offered accounts, which did not come at the cost of accounts elsewhere. This positive result was not shared by

[226] Pascaline Dupas and Jonathan Robinson 'Saving Constraints and Microenterprise Development: Evidence from a Field Experiment in Kenya' (2009) Working Paper 14693, National Bureau of Economic Research; Lasee Brune, Xavier Gine, Jessica Goldberg and Dean Yang 'Commitments to Save: A Field Experiment in Malawi', (2011) Impact Evaluation Series 50, Policy Research Working paper 5748, The World Bank Development Research Group; Ronald Abraham, Felipe Kast and Dina Pomeranz 'Insurance Through Savings Accounts: Evidence from a Randomized Field Experiment among Low-Income Micro-Entrepreneurs in Chile' (2011), unpublished paper.

the men. Roodman[227] speculates that ‘The accounts may have helped primarily by giving women more control over their own impulses to spend in the moment or by giving them a way to deflect family requests for money. Especially if the latter, the women’s gains may have come partly at the expense of relatives outside the control group.’ The authors too suggest that savings may not have increased for men because they already had secure domestic access to savings and so did not need the account, whereas the women were in a less controlling position.

Brune et al’s study of savings in Malawi was a little different, but also showed a positive impact from the offer of savings. In conjunction with Opportunity International in Malawi, smallholder tobacco farmers were offered an ‘ordinary’ savings account, a ‘commitment account’ or (the control group) neither. The commitment group agreed to have money released from sale of one year’s harvest transferred directly in to a commitment account which could not be touched until a few weeks before the next planting season, when it contents were released to buy the necessary agricultural inputs. Take up of both types of account was high.

Those savers who chose commitment accounts had significantly better outcomes than the control group. They were able to buy 48% more agricultural input for the next planting season compared to the control group mean, their crop sales from the subsequent harvest were 27% higher and household expenditure was 27% higher after the harvest. Note, unlike the Kenya studies, the group studied here were over 90% male farmers: the authors did not note if there were any differences in outcome by gender.

The authors do note that positive as this study is for the recipients of savings accounts, ‘the overall impact on the community at large of commitment accounts is likely less positive. This is because of our preferred interpretation that the commitment accounts helped with input utilization precisely by helping farmers withhold resources from others in the community. It is possible, for example, that others in the social network were less able to deal with unexpected shocks (e.g., health shocks) due to reduced assistance from neighbours or relatives who had commitment accounts. While we believe it is unlikely that the net impact of the commitment treatment on communities would be negative overall, we do not shed any

[227] Op. cit. note 211 p. 171

light on this issue in the current paper.'[228]

The final savings study was carried out by Abraham et al in Chile. The authors worked with Fondo Esperanza (FE), a Chilean MFI, and Banco Credichile (BC), a large commercial bank. FE's members are self-employed micro-entrepreneurs, 90% women, living and working in urban areas in the informal sector. The credit disbursement and repayment of their microloans is on a classic, rigid three month loan basis with weekly or biweekly repayment (at group meetings) with little scope to be used as self-insurance for emergencies or shocks. The savings account thus provided this buffer. 4175 members of FE were surveyed, and two-thirds randomly selected to be offered a savings account (by group). Take up was approximately 50%. Follow up was around fifteen months after the savings accounts were opened. The conclusions were very positive: savers were less likely to owe money to relatives, friends or institutions than the control group, and also less likely to have had to reduce consumption due to economic difficulties. The authors did not find those with accounts less likely to lend to others, so did not find evidence that access to a savings account crowds out lending to others. Rather, savings worked as a means of consumption smoothing when other forms of insurance were unavailable.

So what do we conclude from the nine RCTs carried out now on the impact of microfinance on poverty?

There is no indication that microcredit has a positive impact in lifting borrowers out of poverty. There is some evidence that it enables existing micro-entrepreneurs to invest more in their businesses, but no evidence that they do so sufficiently profitably as to have a positive impact on reducing their poverty. Several of the studies did randomise at the community level, so displacement effects are covered, but those in Bosnia and the Philippines did not, and so overall outcomes for the community from the offer of microcredit may have been more negative that these studies are able to suggest. The most positive RCT microcredit study for microcredit was Karlan and Zinman's in South Africa, but these high cost payday lending equivalent loans more show that occasional, short term access to finance at any cost can help prevent a worse problem (such as losing one's formal job) than that microcredit to the classic micro-entrepreneur is a useful intervention.

[228] Lasee Brune, Xavier Gine, Jessica Goldberg and Dean Yang 'Commitments to Save: A Field Experiment in Malawi', (2011) Impact Evaluation Series 50, Policy Research Working paper 5748, The World Bank Development Research Group, p14

The results – admittedly, not all that many yet – for microsavings are more positive. Savers seem to be able to smooth income, use savings as self-insurance and see higher incomes down the line. There is an absence of potential negative effects, but exactly how these accounts help is perhaps not yet fully appreciated. To the extent these accounts help female savers resist demands from friends and family for cash that males have little difficulty resisting, they may empower: but at what cost to those relationships, and whether that is ultimately positive or negative across the community, is not known.

On the best evidence we have, then, that of randomised control studies, there is no clear, direct evidence of positive impact of microcredit on reducing poverty levels. There is some evidence of positive indirect impact through enabling borrowers to manage unexpected demands on income which might otherwise hurt their ability to retain employment in the formal sector: but that is of little relevance to the target client typically aimed at by MFIs, the small scale entrepreneur in the informal sector. The evidence from the RCTs on offering microsavings is more positive. Without suggesting dramatic impact in reducing poverty, it does suggest a positive smoothing effect, a protection against shocks and as a result an improvement in income.

Whilst, for all the reasons outlined in this and the previous section, RCTs remain the gold standard, it is worth noting that in 2010 the UK's Department for International Development funded two systematic reviews of microcredit: that of Duvendock et al,[229] quoted earlier, which whittled 2643 studies of microcredit globally down to 58 considered sufficiently free of methodological flaws to study in depth; and that of Stewart et al[230] which searched three specialist systematic review libraries, 18 electronic online databases, 24 MFI websites and an online directory of books to identify 35 studies of the impact of microcredit or savings in sub-Saharan Africa, of which 20 were excluded due to poor reporting, methodology or both, and 15 were then studied in depth. Stewart et al concluded 'that microcredit and micro-savings have mixed impacts on the poor in sub-Saharan Africa, with both positive and negative impacts on their wealth and their livelihoods..micro-savings appears to be the more successful intervention, both in theory and practice.'[231]

[229] Op. cit. note 196
[230] Ruth Stewart, Carina van Rooyen, Kelly Dickson, Mabolaeng Majoro, Thea de Wet 'What is the Impact of Microfinance on Poor People? A Systematic Review of the Evidence from Sub-Saharan Africa' (2010) Technical Report, London: EPPI-Centre, Social Science Research Unit, University of London
[231] Ibid. p. 6

Duvendock et al's conclusions, as noted earlier, are, if anything, even bleaker: 'our report shows that almost all impact evaluations of microfinance suffer from weak methodologies and inadequate data…thus the reliability of impact estimates are adversely affected. This can lead to misconceptions about the actual effects of microfinance programmes, thereby diverting attention from the search for perhaps more pro-poor interventions.'[232] In their concluding section[233], they find that most of the effects they assessed were both positive and negative; the bulk were statistically insignificant and a significant number did suggest negative outcomes. They did not feel able to reach a conclusion about the impact of the microfinance sector as a whole; 'we can neither support nor deny the notion that microfinance is pro-poor and pro-women'. This causes them to question whether there might not have been better interventions that did better benefit poor people/empower women over the past decade or so. They note: 'There are many other candidate sectors for development activity which may have been relatively disadvantaged by ill-founded enthusiasm for microfinance.'[234] They note that even within microfinance, the 'putative success of basic models of lending such as the Grameen Bank and related models' may have diverted attention from potentially better models such as savings and insurance.

Duvendock et al's call is then for more and better research, to obtain 'a clearer picture on the impacts of microfinance, on whom, where, and when (e.g. under what circumstances), and the mechanisms which account for these effects.'

That is hard to argue with; the conclusion of this chapter on the micro effects of microcredit on borrowers in reducing poverty is that the case is that there is a lack of evidence to this effect (though Roodman and Morduch's point that absence of evidence is not evidence of absence is also true). RCTs and Strategic Reviews alike find no positive impact of microcredit reducing poverty. What then of macro effects?

III. Evidence for the Macro Effects of Microfinance/The Wider Impacts of Microfinance

Section II examined the impact of microfinance on poverty levels of those who take advantage of its offer. No clear evidence of positive impact was found. But when considering whether to support microfinance as a public policy, whether public and private donors do

[232] Op. cit. note 196 p. 4
[233] Op. cit. note 196 p. 74
[234] Op. cit. note 196 p. 75

well to provide at least initial subsidy, we want to know more than just the impact of microfinance on those to whom it lends: we want to know the impact, positive or negative, on the wider community as well. This section addresses the possible impact on the poverty levels of the wider community in which microfinance is offered: the next Chapter will attempt to do the same with regard to empowerment issues.

The case for how microfinance could have a positive impact in reducing poverty in the wider community in which it operates is straightforward to make. The provision of capital to small-scale entrepreneurs provides the tool that has been the only thing preventing poor would-be entrepreneurs founding their own business. They now start these businesses: grow them: have more income to spend from the profits, employ more staff which in turn stimulates the local economy and reduces the poverty of the people now employed.

Unfortunately, after thirty or forty years of established microfinance, there is a lack of evidence of any very much of this happening. The vast majority of micro-enterprises never go beyond employing the micro-entrepreneur herself and sometimes members of her family. Where these other members of the family are children who might otherwise be in school, especially in countries with universal free education, it is hard to believe that the wider impact of microfinance for them is a positive. One might have thought that with the billions of dollars of subsidy microfinance has received from international donors and the amount of academic effort that has gone into it over the past thirty years, that there would be some evidence of a positive macro effect. But, in fact, we have a limited body of recent, fairly sceptical work that examines the evidence and finds only negative effects at the macro level from microfinance. The arguments are threefold: that microcredit simply displaces economic activity with no net gain; that it lacks scale and as a result entrepreneurs seldom develop in to small and medium sized enterprises (SMEs) which are the true engine of development; and that it has diverted developmental aid that could otherwise have gone productively in to developing SME sectors in impoverished countries.

Looking at the historical evidence of how countries have in fact developed, Bateman and Chang argue:

> exhaustive analysis of these countries that reached development status in the 1800s and early part of the last century (the USA, Western Europe and Japan) as well as the fastest growing countries of the last thirty years or so (China, Taiwan, South Korea, Thailand, India, Malaysia and most recently Vietnam), show that the microfinance model has played no role whatsoever. To the contrary, these countries have very successfully reduced poverty and grown rich(er) overwhelmingly by using a range of state co-ordinated policy interventions, financial institutions and investment strategies that are not only the complete opposite of

today's 'new wave' microfinance model, but also….very likely to be undermined by the proliferation of microfinance and its prior claim over savings and other important financial resources. [235]

Displacement effects are the jobs and incomes lost by existing microentrepeneurs as a result of the new entry or expansion of microenterprises that have been facilitated by the provision of microfinance. There is demand for only so many tomatoes, and hence only so many tomato-sellers. A new entrant may simply just reduce the margins of all by increasing supply when there is no increase in demand, so driving down the price, or may push an existing tomato seller out of business. Increases in supply of petty trading businesses may have the positive impact for consumers that prices fall absent an increase in demand, but without that increase in demand there is no reason to suppose that microfinance creates additional jobs and incomes in a community. That it does so for one client microenterprise does not mean it does so for the whole community: that is the 'fallacy of composition'. Just occasionally, a new technology or innovation will create a source of new demand, but even then these effects eventually come in to play. Chang describes the following example:

> When a microfinance institution first starts its operation in a locality, the first posse of its clients may see their income rising – sometimes quite dramatically. For example, when in 1997 the Grameen Bank teamed up with Telenor, the Norwegian phone company, and gave out microloans to women to buy a mobile phone and rent it out to villagers, these 'telephone ladies' made handsome profits - $750 - $1200 in a country whose annual average per capita income was around $300. However, over time, the businesses financed by microcredit become crowded and their earnings fall…by 2005 there were so many telephone ladies that their income was estimated to be only $70 per year, though the national average income had gone up to $450. [236]

Most micro-financed enterprises do not even have this advantage of launching in to an area of unsatisfied demand. The range of businesses open to the poor on developing countries is limited by their skills, the narrow range of technologies available, the loan size they can raise, and the cash flow demands of their lender. Hence the emphasis on market stalls and petty trading. Pessimistically, we might note that whereas Roodman and Banerjee et al may hope that a re-measurement of those clients and non-clients covered in the Spandata study might show more positive impact of microcredit after three years than was observable after eighteen months, with such a high failure rate of businesses and displacement effects also taking time to come through, a study three years on might very well show a much more negative impact than at eighteen months.

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[235] Milford Bateman and Ha-Joon Chang, 'The Microfinance Illusion', (2009), University of Jurag Dobrila Pula, Croatia, and University of Cambridge, UK unpublished paper available at http://hajoonchang.net/2009/03/05/the-microfinance-illusion, p. 5
[236] Ha-Joon Chang *23 Things they didn't tell you about Capitalism* (2011) London: Allen Lane p. 164

Displacement issues aside, why do so few microenterprises go on to become SMEs, increasing employment and becoming the growth engines for the future? The short answer is that they are just not profitable enough to retain any earnings with which to grow. Why they are not sufficiently profitable to grow will be discussed, but considering overall profitability first, Karnani[237] quotes a study by the George Foundation (an NGO targeting poverty alleviation in India) of 50 microcredit programs in 17 villages in South India where less than 2% of the microenterprises continue past the first three years. Emran and Stiglitz[238] explain that most microenterprises financed by microfinance only seem profitable at all because they do not value the time and labour of the microentrepeneur. Hence a poor microentrepeneur can use a loan to buy a goat and sell the milk, but she can never grow because as soon as she takes on the cost of hiring someone at a market wage to do so, it becomes unprofitable to expand.

Why are most microenterprises barely profitable? Clearly the high interest rates they pay for capital must be part of it. It is also somewhat chicken-and-egg: their lack of scale is an important negative driver. Enterprises need scale to achieve low cost operations, increase productivity and thus profitability for reinvestment and expansion. For almost any activity, there is a minimum efficient scale of production. An overemphasis on microfinance may mean that these are rarely achieved. Karnani[239] observes that the average firm size in India is less than one tenth the comparable size in other emerging economies. He observes: 'Rather than lending $200 to 500 women so that each can set up a microenterprise manufacturing garments, it is much better to lend $100,000 to an entrepreneur with managerial capabilities and business acumen and help her to set up a garment manufacturing business employing 500 people. Now the business can exploit economies of scale, deploy specialized assets, and use modern business processes to generate value for its owners and employees.'

The wider impacts of microfinance on its communities look most damning when development of countries that have relied on it more or less exclusively are compared to those which have chosen other routes. Bateman and Chang surveyed countries reaching development status in the 1800s through to the early 1900s as well as over those that have

[237] Aneel Karnani 'Undermining the Chances of Sustainable Development in India with Microfinance' (2011) in Milford Bateman (ed.) *Confronting Microfinance: Undermining Sustainable Development* Sterling, VA: Kumarian Press
[238] Shahe Emran and Joseph Stiglitz 'On selective indirect tax reform in developing countries' (2005) *Journal of Public Economics* vol. 89 issue 4 pp. 599-623
[239] Op. cit. note 237 p. 90

grown fastest over the past thirty years or so and found that the microfinance model paid no role at all[240]. Bateman observes:

> Crucially, Bangladesh as a whole stands out as having been almost entirely left behind by its rapidly growing East Asia 'tiger' economy neighbours. This is not a coincidence, but a result of policy choice. By and large, the successful 'tiger' economies all opted to deploy a pro-active, subsidised, policy-based but nevertheless well-managed local financial model radically different to the Grameen Bank microfinance model that today dominates in Bangladesh…Simplifying, the heterodox East Asian local financial model is marked out by the provision of affordable financial support for scaled-up formal sector small businesses and family firms that can efficiently link up with other sectors of the economy (i.e. with state companies, larger private businesses, marketing co-operatives…Turning to the very many developing countries, regions and localities that have also deployed the Grameen Bank microfinance model, they appear to have fared no better than Bangladesh. Effectively diverting their scarce financial resources into the tiniest of informal microenterprises, these countries have generally seen little economic or social benefit over the longer term and, indeed, most eventually ended up having to deal with a destructive sub-prime-style 'microfinance meltdown' scenario. Bolivia, Mexico, Cambodia, Nicaragua, Morocco and, most stunning of all, the Indian state of Andhra Pradesh in late 2010, all are now viewed as how microfinance can seriously destabilise and undermine the local economic and social structures of most benefit to the poor, not strengthen them. [241]

The bleakest assessment of the macro impact of microfinance comers from the Inter-American Development Bank[242], which assessed the role of microfinance in Latin America, particularly Mexico. As Harper[243] reports: 'Arguing that the root cause of poverty and underdevelopment in Latin America is the growing tendency of largely unproductive microenterprises and the self-employed to absorb the country's scarce financial resources, while the far more productive small and medium enterprise sector goes without, the IDB effectively pulled the rug from under the microfinance industry. For the first time, a mainstream international development agency was arguing that a major misallocation of capital has taken place in Latin America these last two to three decades, and the situation needed correcting fast.'

We have seen little positive evidence of microcredit raising borrowers out of poverty, either at a micro or macroeconomic level. Given equal importance in its early claims, as we saw earlier, is the claim of microfinance that it empowers its borrowers, especially its female borrowers. The two RCTs that have examined this claim have broadly found no positive

[240] Op. cit. note 235 p. 5
[241] 'Confronting Microfinance Myths and legends in the Western Balkans' (2011) in Indian Microfinance Business News, August 22 2011
[242] Carmen Pagés (ed.) 'The Age of Productivity: Transforming Economies from the Bottom Up', (2010) Washington, Inter-American Development Bank; New York: Palgrave Macmillan
[243] Malcolm Harper 'The Commercialization of Microfinance: Resolution or Extension of Poverty?' (2011) in Malcolm Harper (ed.) *Confronting Microfinance: Undermining Sustainable Development*, Sterling, VA: Kumarian Press, p. 54

impact on issues of empowerment, either. The next chapter considers all the evidence for microfinance empowering – and indeed disempowering – its borrowers.

Chapter 9: Does Microfinance Work as a Tool of Empowerment?

What does the microfinance industry mean when it claims to empower women? The World Bank defines empowerment as 'the process of increasing the assets and capabilities of individuals or groups to make purposive choices and to transform those choices into desired actions and outcomes…Empowered people have freedom of choice and action. This in turn enables them to better influence the course of their lives and the decisions which affect them.' Acknowledging that perceptions of being empowered vary across time, culture and domains of a person's life, the World Bank summarize: 'In essence empowerment speaks to self-determined change.'[244] In defining empowerment in this way, the World Bank draws on the academic literature where, classically, empowering a woman is defined by Kabeer[245] as the process by which those who were denied the ability to make strategic life choices, acquire this ability; empowerment is the ability to make choices and it entails a process of social change. In the language of Nussbaum, it is adding to a woman's capabilities, which she may or may not turn in to functionings.

Where Kabeer and the World Bank speak of empowering, this thesis has spoken of possessing and enhancing or diminishing autonomous agency, and enhancing or diminishing the scope of autonomous action available to an agent. Recall that the autonomous person was defined early on in this thesis as one who is competent (at a threshold level defined by possessing a minimal rationality and an ability for self-reflection) to be self-determining, and has freedom to act as she chooses, although the latter component of autonomy will be held to different degrees by different people at different times in life. Autonomy was defined in terms of an agent's self-determination: the more able she was to set her direction and choose her own goals from her own values, the greater the level of autonomy she had. The academic and World Bank's definition of empowerment is the process of going about developing this. Empowerment, it seems, is the process by which an agent increases the level of her global autonomy.

The claim that microfinance can empower, or ultimately lead to an increase in the autonomous agency of a woman is no small one. Yet we have seen throughout this thesis that some of microfinance's current practices can in fact exploit, coerce and sometimes paternalise, all of which can be seen as forms of disempowerment. The previous chapter has

[244] 'What is Empowerment?' The World Bank, 2011, available at http://go.worldbank.org/V45HD4P100
[245] Naila Kabeer 'Resources, Agency, Achievements: Reflections on the Measurement of Women's Empowerment' (1999) *Development and Change* vol. 30 (3) pp. 435-464

found this not to be justified by the alleviation of poverty, because of the lack of positive evidence that poverty is, overall, alleviated by microfinance. What is the evidence, then, of a strong empowering effect that would compensate for the undermining of autonomy that has been observed?

The focus here is on social empowerment. The microfinance industry embraces two different conceptions of empowerment. The 'financial inclusion' model focuses on how access to credit can open up possibilities for a borrower of control over her own financial life. It refers simply to economic empowerment: a borrower is empowered simply by generating wealth, which increases her choices in life and her independence. Since, as we saw in the previous chapter, there is no clear evidence that credit does in fact generate net wealth, this form of empowerment *overall* is not to be found, although of course some individuals will enjoy it.

The second, and original, use of empowerment, used by the developers of microfinance in Bangladesh, encompassed this economic version of empowerment in their definition of empowerment, but also saw a much more radical impact on the social structure within which the borrowers lived. They saw microfinance, through its group lending structure, empowering women not just to increase their realm of autonomous action within society, but empowering them to challenge the social norms of that society itself. Roy[246] calls this the 'Bangladeshi' model. In a society generally accepted as being repressive to women, Bangladesh microfinance firms wanted to use the group lending model (hierarchical as it itself was) to challenge and indeed change some of these norms: the intention was to create a sense of solidarity through the groups that would allow other services to be delivered including a commitment to political participation. Hence Grameen's '16 Rules' which, as we saw in Chapter 7 did have a positive role in encouraging some forms of empowerment: but in fact made little headway against the most ingrained issues of caste and dowry.

Empirical studies measuring overall empowerment are even thinner on the ground than those measuring poverty. A notable study by Hashemi, Schuler and Riley[247] in Bangladesh tried to do so, using eight different indicators by which to measure empowerment[248]. Measuring these before and after credit was extended, they did find an empowering effect; but

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[246] Ananya Roy, *Poverty Capital: Microfinance and the Making of Development* (2010) London: Routledge p. 104-112

[247] Syed Hashemi, Sidney Ruth Schuler and Ann Riley 'Rural Credit Programs and Women's Empowerment in Bangladesh', (1996) *World Development* 24 (4) pp635-53

[248] These are: mobility, economic security, ability to make small purchases, ability to make larger purchases, involvement in major household decisions, relative freedom from domination within the family, political and legal awareness, and involvement in political campaigning and protests, p648

unfortunately there was no control group of potential, would-be borrowers, so we do not know whether or not it was just more empowered women who signed up for microfinance in the first place, a potential selection bias the authors acknowledge.

A lot of early research studies claimed that microcredit increased mobility and strengthened networks among women who were previously confined to their homes.[249] But the position is complex. In Asia at least, it is not uncommon for women to hand over control of the loan to their spouse, or invest it in a family enterprise.[250] Goetz and Sen Gupta argue that what is really happening is that 'the household is internalizing the high transaction costs of lending to men…These costs are primarily those of monitoring men's loan use and enforcing regular repayment. Women in effect offset these costs by using intrahousehold gender relations of obligation or persuasion to recover weekly loan repayments.'[251] Women can fulfil this role of internalising the costs of lending to men within the household because they 'are easy to locate, being much less able than men to leave a locality temporarily to evade field workers, and they are easier to intimidate into repayment than men, who can always threaten violence.'[252]

It was perhaps always unlikely that access for women to credit by itself would overturn entrenched patriarchal systems of control where these existed. In societies where women's secondary status has many causes – lack of access to financial services being only one amongst many such as lack of property rights, lack of power over divorce procedures and settlements, lack of control over custody of children in the event of divorce – just tweaking one of these issues may not be enough to change the overall social norm.

Matters are complicated further by the fact for some women, empowerment came when they had enough extra income to restrict mobility and choices by opting for some form of purdah, the concealment of a woman's form and restrictions on contact with males from outside the kinship group, which could not be observed if one was working in the field all day. Kabeer notes 'If empowerment entails the extended capacity for making choices then…the paradox is

[249] E.g. David Hulme and Paul Mosley *Finance Against Poverty* vol. 1, London: Routledge 1996; Muhammad Abdul Latif 'Programme impact on current conception in Bangladesh', (1994) *The Bangladesh Development Studies* vol. 22 (1) pp. 27-61; Sidney Ruth Schuler and Syed Hashemi 'Credit Programmes, women's empowerment and contraceptive use in rural Bangladesh' (1994) *Studies on Family Planning* vol. 25 no 2 pp. 65-76.
[250] Anne Marie Goetz and Rina Sen Gupta 'Who Takes the Credit? Gender, power and control over loan use in rural credit programmes in Bangladesh' (1996) *World Development* 24 (1) pp. 45-63
[251] Ibid.
[252] Ibid.

that in many cases, this leads women to opt for some form of purdah if they can afford to, both to signal their social standing within the community and to differentiate themselves from those women who do not have this choice.'[253]

These women, in an impact study measuring mobility, one of Hashemi et al's criteria, would count as less empowered, implicitly leading to less autonomy. But they are the real life examples of Oshana's Taliban woman in Chapter 1; they are exercising their rational agency, now they have greater scope of autonomous action in which to do so, to limit their own freedoms. It may seem paradoxical, but it is an autonomous choice.

A recent study has shown the picture to be even more complex than this presentation of it has been so far, however. A study of two villages in Bangladesh[254] repeated the finding that the husbands usually took control of the loan, but went further: men used their patriarchal authority to compel women (wives, mothers, sisters) to get the loan as the NGOs (BRAC and Grameen) would not lend to them as men. Intimidation was used if the woman refused. There usually was a temporary improvement after taking the loan in the family's economic position, and this was then used by the men to buy their wives *burkhas* or *hijabs* to wear as a symbol of their new-found wealth and prestige. It was entirely unclear that the women in this study themselves wanted to adopt this dress. The authors reflected that 'we could not find any hard evidence to support the view that microcredit empowers women or promotes their liberation…The microcredit programme does not directly challenge any official views that subjugate women.'[255] Where they did find economic empowerment – they cite a case of a woman who successfully sets up a hand-rolled cigarette business, unfortunately using cheap child labour as the only way of making it profitable – they did not find social empowerment followed. The profits were used by this woman to pay increased dowry for her daughter.

An interesting (and also somewhat paradoxical) example of the original, positive use of the group lending mechanism to deliver empowerment is Maddocks'[256] study of the Small Enterprise Foundation (SEF)'s efforts to increase awareness of HIV/AIDS among its staff and clients in the Limpopo province where it operated, in 2001. Here, 24% of all deaths were

[253] Naila Kabeer 'Conflicts over credit: re-evaluating the empowerment potential of loans to women in rural Bangladesh', (2001) *World Development* 29 (1) pp. 63-84
[254] Aminul Faraizi, Taskinur Rahman, Jim McAllister *Microcredit and Women's Empowerment: A Case Study of Bangladesh* (2011) London: Routledge
[255] Ibid. p. 118
[256] William Maddocks 'How can Microfinance Programs Help the Struggle Against Social Problems such as Begging, Child Labor, Prostitution, Violence Against Women, Criminality, Gangs, and Drug Addiction?' (2011) Commissioned Paper for the 2011 Global Microcredit Summit, Valladolid.

as a result of AIDS, or 28% amongst women. SEF linked their microfinance operation to the health education work of The Rural AIDS and Development Action Research program (RADAR). SEF loan group members were met with every two weeks to discuss gender inequality, partner violence and how AIDS was typically spread. SEF director John DeWit reports: ‘what we found was during the first four sessions of SFL training, people really hated it; they really strongly opposed it because of the sensitive issues it was raising, such as “Do you have a son who is a migrant worker who has a girlfriend in Joburg who, when he comes home, might be infected.”’ Members were compelled to stay, however, to get their loans, and over time came to value the training and even pass it on: client retention rates amongst those who had received the training rose. The study looked at the impact of microfinance on poverty and empowerment by taking one group that had received the training and one that had not, as well as a control group, and showed that only those who had had the training demonstrated increased empowerment. (This study did include drop-outs as well.) Specifically:

> participation…was associated with increased ‘power within; measured by greater self-confidence, financial confidence, as well as more progressive attitudes to gender norms. Women with an intimate partner reported an increase in ‘power to’ measured by higher levels of autonomy in decision making, greater valuation of their household contribution by their partners, improved household communication and better relationships with partners…Over a two year period, levels of intimate partner violence were reduced by 55% in women in the intervention group relative to those in the comparison group.[257]

Those aged 14-35 years became less likely to have unprotected sex. Despite the initial resistance, one woman commented: ‘These things were secret. I never used to talk to my daughter about using condoms or prevention. I am grateful of health talks because they have helped me. My children are listening to me. Such knowledge makes any parent to be brave in facing their children.’

These are powerful results: the irony is, of course, that the increase in empowerment observed in the treatment group to talk more freely about sexual and violent matters, had to be coerced on to them through refusing to continue with microfinance lending unless they had the initially hated training. Perhaps a more perfect example of justified hard paternalism could hardly be found than this, where partner violence fell by 50% for those paternalised. Note though that this is only partially a victory for the concept of microfinance as empowerment. It is the knowledge these women gained that empowered them: microfinance was merely the mechanism for forcing them to acquire it.

[257] Ibid. p. 7

A recent study from India[258] provided another example of a microcredit program being used to empower women in fields beyond simply finance. Chakravarty and Chaudhuri show how nongovernmental activists were able to encourage microcredit groups to look beyond their pure credit function and mobilize against domestic abuse, alcoholism and the practice of witch hunts which were not uncommon in the area studied (the tea plantations of Jalpaiguri). Tribal workers' belief in the existence of witches and willingness to kill the 'witch' (often blamed for diseases in villages with no doctors or medical facilities), especially when fuelled by alcohol, were easier to counter and stop when the microcredit group banded together to resist the tradition.

The problem with the group lending model being used to coercively empower its members, to their benefit in cases where the programme bolted on to the offer of credit was designed to empower, is that of course that same group lending model can be coercively used to disempower.

Where a borrower has fallen behind on payments, loan collection methods used by an MFI may be coercive and shaming, as was seen in Chapter 5. Arunachalum[259], quotes the extreme case of an eight year old girl kidnapped by a moneylender[260] operating as an agent for an Indian MFI and held as collateral until her parents made the due payment on a debt (he notes that the local microfinance bank then, and still months later, listed women's rights and 'empowering the girl child' as its key priorities). But, because the group liability model requires a struggling borrower's peers to cover her payments and they are often around the poverty line themselves, the group peers' methods of loan collection may be even worse than the MFI's. Karim[261] and Rahman[262] both describe cases of ostracization, housebreaking, violence and asset removal being used by peers to make good some of their loss. The female empowerment narrative runs that in the group lending model, borrowers support each other and willingly help each other out in time of need. And of course perfectly genuine examples of this are true. But when times are tough – and we are discussing the poorest here, so that is not rare – powerful incentives work the other way.

[258] Anuradha Chakravarty and Soma Chaudhuri, 'Strategic Framing Work(s): How Microcredit Loans Facilitate Anti-Witch-Hunt Movements' (2012) *Mobilization* vol. 17 no. 2
[259] Ramesh Arunachalum *The Journey of Indian Microfinance: Lessons for the Future* (2011) Chennai: Aapti Publications, p. 18-19
[260] Named as Mrs Lalitha, awaiting trial when Arunachalam's book was published
[261] Op. cit. note 131
[262] Op. cit. note 127

Conceptually, it is perhaps not surprising that there is so much ambiguity over whether microcredit empowers, overall, or not. The offer of credit can empower a poor woman by enabling her to start an activity that generates income for herself and over which she has control (although it can of course also over-indebt her and she may not in fact have control over the income produced). But even on the best case, assuming the offer of microcredit itself empowers, the form through which it is (mostly) offered, group lending, is inherently disempowering. Even where there is individual lending rather than group liability, the fact that it is still (largely) done in groups places heavy burdens on the borrower. It may start off by empowering borrowers against poverty and indeed culture, by challenging social norms, but end up reinforcing patriarchal norms to ensure repayment. Repayment has to be ensured somehow, or the MFI will become bankrupt: coercive peer and loan officer pressure replaces collateral. The traditional set up of a group of poor women gathering weekly to have their loan repayments paid over to a (usually male) loan officer who may berate and enforce sanctions such as not allowing anyone to go home until the last payment is made, and most of all, to take on personal liability for the repayments of others in their group, is inherently disempowering. As a USAID consultant reflected to Roy:[263] ‘Do you and I, as women borrowing from a bank, have to do this when we take out a loan from the Bank of America?..Why do poor women?..And how can this pass as women’s empowerment? True empowerment is to have a choice; to be able to purchase a service without all these conditions and rituals.’

Mayoux et al summarise the two sides of this as follows:

> Many programmes are group based. Group formation can reinforce the development contribution of microfinance through providing an organisational base for non-financial services and information in areas like enterprise development, health, literacy and gender equality. Likewise, the groups can provide a base for collective community action, networking and advocacy, and strengthening of civil society and democracy. Examples exist of microfinance programmes which have made all of these potential contributions to development. However an increasing body of evidence shows that badly designed microfinance programmes may increase rather than reduce poverty through creating a downward spiral of debt. Thus, female-targeted microfinance may disempower women through shifting on to them the full burden of family savings and debt. Women may not control their own incomes and men may divert more of their incomes to their own personal expenditure. [264]

It is of course possible to advocate microfinance without the group lending model. But we have largely yet to get beyond it as way for MFIs to secure repayment. But as Mayoux puts it

[263] Op. cit. note 246 p. 49
[264] Linda Mayoux, Margaret Jiri and Marinela Cerqueira, *Microfinance for urban poverty reduction: Sustainable Livelihoods Project, Angola* (2002) One World Action

‘Unless micro-finance programmes move beyond complacent assumptions about automatic contributions of group formations to women’s empowerment, they risk becoming little more than another cynical self-help means of shifting the costs of development onto poor women.’[265]

Attempting to sum up a net, overall, level of empowerment or otherwise is impossible, in part because we do not have adequate data, and in part because each study that has been done is so locally economically and socially specific, generalisations seem to make little sense. However, a recent study by Kabeer et al[266] returns to the widespread study of the impact of work, including that financed by microfinance, on the empowerment of thousands of Bangladeshi women.

Kabeer et al observe the revolutions that have taken place in life for women since Bangladeshi independence. She cites three major changes: a massive effort on the part of the government to reduce fertility rates, which has indeed brought fertility down from around 7 in the late 70s to around 3 now, in the process opening up a sector of employment for women; the microcredit revolution, leading to a significant increase in women’s economic activity, though largely in the informal sector; and the adoption of the New Industrial Policy in the 1980s, emphasising export-orientated industrialisation and labour-intensive garment manufacture in particular.

As Kabeer et al observe, women’s economic activity rates have increased, but have stayed within a very narrow range of occupations, largely compatible with their domestic roles and in the informal sector. She sets out to examine if this has transformed power relations between men and women, or whether a woman remains at ‘patriarchal risk’ throughout her life – at risk of a collapse in social status and material wealth if deprived of the protection of first father, then husband, then son. Kabeer et al note that most studies on the effect of women’s empowerment of paid work have focused only on microfinance and the export garment industry, and limited their notion of empowerment to a woman’s role in decision making and mobility in the public domain. Kabeer et al aimed to use measures of empowerment, by contrast, that captured ‘women’s sense of self-worth and identity, their willingness to question their own subordinate status, their control over their own lives, and

[265] Linda Mayoux, ‘Tackling the Downside: Social Capital, Women’s Empowerment and Micro-Finance in Cameroon’ (2001) *Development and Change* vol. 32, p. 462
[266] Naila Kabeer, Simeen Mahmud and Sakiba Tasheen, ‘Does Paid Work Provide a Pathway to Women’s Empowerment? Empirical Findings from Bangladesh’ (2011) *IDS Working Paper* no. 375

their voice and influence within the family'[267] as well as 'women's political consciousness and agency...awareness of their rights, their agency as citizens and…their willingness to take collective action against social injustice.'[268]

Kabeer et al interviewed a sample of 5198 women aged over 15 from locations spread over eight districts in Bangladesh, chosen to represent different socio-economic conditions. They were then divided by primary occupations into those who did paid work outside the home (13%), subdivided in to work in the formal (4%) and informal economy (9%), paid work within the home (46%), unpaid subsistence production (15%) and economic inactivity (22%). Within these groupings, it should be noted, informal work outside the home would be largely represented by those working through microfinance loans: many of those working informally inside the home would also be taking microfinance loans (to rear cows, for example.)

Each group was then measured for control over income; mobility in the public domain participation in public life, and attitudes and perceptions.

With regard to control of income, most women across all groups retained some income for their own use, but there was a significant difference between those in paid, formal work and the rest. Almost all of this group did so, and a much higher proportion of this group (90%) could choose their own clothes and had a savings or insurance account (24%) against around 80% and 8% for those working in the informal sector and 42% and 10% for those in subsistence production. In terms of control over income, then, there was a significant (positive) difference in empowerment for women in the informal sector dominated by microfinance borrowers, but a more significant difference again between them and those in the paid formal sector.

With regard to mobility in the public domain, women were asked if they were comfortable going unaccompanied to a health clinic (public space associated with their reproductive role in the family); the market (representing their role in as producers and consumers) and whether they were able to visit their natal family (women in Bangladesh typically leave their own family for that of their husband on marriage, who is not usually from the same village, so the woman is classically cut off from her own birth family's support.)

[267] Ibid. p. 10
[268] Ibid. p. 10

Overall, only 24% of women were comfortable visiting their families after marriage; and only 18% visiting a health facility and 11% the market. In all cases, higher percentages of those in paid formal work were comfortable doing these activities (32%, 50%, 36%), with those working in the informal sector outside their home not too far behind. Looking at this from the perspective of microfinance borrowers, it is suggestive that if the trade chosen by the microfinance borrower pushed her out of the home in to the market, she then felt much more empowered to visit health facilities or the natal family than a borrower working inside the home. This suggests that a rise in empowerment for microfinance borrowers here reflects not exactly the extension of credit as such, but whether the borrower employs it in or outside the home, the latter creating an empowering effect.

With regard to participation in public life, measured by knowledge of labour laws, consultation by others, voting and own decision in voting, attendance at rural committee meetings unaccompanied and even participating in protests, there was a gulf between those in the formal sector and the others: 48% of those in paid labour knew labour laws, only 11 – 14% of the other economically active groups. Similarly, 52% of formal workers might be consulted by others, only 27-33% of the economically active rest: in the last two categories, the economically inactive outscored them. Most voted, and most took their own decision in voting. 17% of formal sector workers would attend a committee meeting unaccompanied as would 13% of those working informally outside the home, but only 4 – 7% of the rest, suggesting again that working outside the home encouraged a willingness to take part in other activities outside it as well. Almost no one (0-0.4%) had participated in a protest, bar the formal workers (largely garment workers), 4% of whom had, those most likely to have had contact with trade unions and womens' rights organisations.

In terms of beliefs and perceptions, almost all agreed that a woman's own income was important for her self-reliance, and that husbands should help working wives with housework and childcare, whether they actually received it or not. Whilst 28% of formal workers thought their income had increased respect for them in the community, only 20% of those working outside the home in the formal sector thought this and just 14% working in the informal sector inside the home. Asked what was the most significant new resource in women's lives in general and for themselves, an overwhelming 80% considered this to be access to education; only 10% thought access to credit. This was higher amongst those actually working in the informal sector outside the home, but still hardly a ringing endorsement of women's belief in the power of microcredit to empower.

Kabeer et al conclude that 'it is the nature of the women's paid work, rather than the simple fact of earning money, that has the potential to bring about shifts in gender relations in terms of how women view themselves and how they are viewed by others, as well as in their capacity for voice and agency.'

Kabeer et al's next stage of analysis was to use multiple regression techniques to control for relevant differences in individual, household and location-specific characteristics. They included a number of variables strongly correlated with their indicators of womens' empowerment: but access to loans did not prove significant, and was dropped. Given the claims of MFIs to empower their borrowers, this absence of correlation between access to loans and empowerment indicators is startling. There was high correlation between NGO membership and greater mobility in the public domain, autonomy in voting, optimism about the future and capacity to deal with difficult circumstances. In Bangladesh, of course, the largest NGO, BRAC, as well as Grameen, operates as both an NGO and an MFI. The social side of their activities may, then, very well empower women, so their claims are not baseless – but it is not the credit doing this, but the social support, the collective endeavour, at least originally.

Education was what in fact had the highest correlation with empowerment, especially at secondary and higher levels. One surprising correlation not usually measured in the academic literature was watching TV (often done collectively), in broadening women's horizons.

Kabeer at al. were unable to differentiate between the different NGOs in their sample. NGO membership clearly increased mobility in the public domain. They observe that other studies[269] suggest that the purer the focus on microcredit (as opposed to the other social aspects), the more impact was limited to purely economic impact and was not otherwise empowering. A subsequent study by Kabeer, Mahmud and Castro[270] has followed this up. Studying a range of NGOs in Bangladesh that covered a spread from microcredit only (ASA) to social mobilisation and awareness training only, with BRAC and Grameen in the middle, it was found that the pure offer of microcredit led to no increase in empowerment: offering social programmes only added the most, and mixed programmes hovered between the two. Access to credit, then, did not empower: NGO's specialised training did.

[269] Nabila Kabeer 'Between Affiliation and Autonomy: Navigating Pathways of Women's empowerment and Gender Justice in Bangladesh', (2011) *Development and Change* 42.2: pp. 499-528

[270] Nabila Kabeer, Simeon Mahmud and Jairo Guillermo Isaza Castro, 'Strategies and the Challenge of Development and Democracy in Bangladesh' (2010) *IDS Working Paper* 343

Kabeer et al.'s work suggests that formal paid work has empowering effects on women beyond just the increased income: but this was much less clear of those working in the informal sector. There were some empowering effects on those working outside the home, far fewer on those using their microfinance loans to work inside the home. For both formal and informal workers, it was the nature of the work done (whether it was outside the home, its status in society) that correlated to empowerment, not the extension of credit as such (which was not correlated to empowerment at all.) The empowerment MFIs believe they have seen coming to women borrowers, then, would seem to come from the extent to which the MFI has worked with its borrowers outside the field of pure credit - to educate, to train, to provide solidarity, as with the sexual health education in South Africa and the fight against witch hunts in India. Women's solidarity and interest groups empower. Credit per se does not. Credit can disempower if it becomes a debt spiral, so whether microcredit overall empowers will never have a clear answer: it will depend in how and to whom and with what solidarity-building it is offered. The irony is that if the aim is to maximise empowerment, the best vehicle might seem to be microfinance without the credit!

The narrative for microcredit empowering women runs that to access credit, especially in groups, enables women not only to start their own businesses, but to meet outside the home, build some collective solidarity, have money of their own to control, increasing their status in the household and then use the profits to enhance the health and education of the whole family. There are anecdotes and case studies to demonstrate all of these in particular instances, at least in microcredit's early days. Perhaps when microcredit was more novel, these positives had few negatives to offset them and microcredit could indeed be held to empower, even if it never did much to reduce poverty.

Now microcredit is more developed and we have reached saturation point in a number of markets, with ensuing repayment crisis, we have an equal number of anecdotes and studies that show the disempowering effects of credit when a borrower is unable to repay – from reduced income, reduced status, shame, isolation from the community and ultimately, in extreme cases, suicide. It is no longer possible to be confident that microcredit, overall, net empowers. In the absence of much hard evidence that can quantify the empowering gains and losses, it is hard to say much either way: other than that the empowering gains, whilst worthwhile, seem fairly modest outside of where microcredit is used as a mechanism (a coercive mechanism in the case of the South African health study) to introduce a separate route to empowerment, such as health education. Where microcredit has led to disempowerment, however, it has been of catastrophic scale. It can only be observed that, just as the last chapter was unable to show a clear positive impact of microcredit in reducing poverty, this is unable to show a clear, positive impact in empowering its borrowers.

Kabeer sums it up as follows:

> And finally, to return to the question with which we started the paper, it is clear that while access to financial services can and does make important contributions to the economic productivity and social well-being of poor women and their households, it does not "automatically" empower women – any more than do education, political quotas, access to waged work or any other interventions that feature in the literature on women's empowerment. There are no magic bullets, no panaceas, no blueprints, no readymade formulas which bring about the radical structural transformation that the empowerment of the poor, and of poor women, implies. These various interventions are simply different entry points into this larger project, each with the potential for social transformation, but each contingent on context, commitment and capacity if this potential is to be realised. [271]

We saw in the previous chapter, however, some evidence that access to savings, as opposed to credit, can raise income and indeed empower. The work of Rutherford[272] and more recently Collins et al[273] has used financial diary keeping[274] with the impoverished in a number of different countries to get at, firstly, just how complex the financial life of the poor is, and how this can be alleviated not (or not only) with the simple, blunt instrument of a loan, but with access to a suite of financial services – savings, insurance, flexible loans (moneylenders may be much more flexible with regard to repayment than MFIs), short term loans from kin. The central observation of *Portfolios of the Poor* is that the poor do not live on $2 a day: they live on $3 one day, 50c the next, nothing for a while, etc.: income comes from a variety of sources, is not reliable, and is barely able to cope with emergencies when they come along. With little access to secure savings accounts, a small surplus one month may simply be spent, leaving nothing to fall back on when a large lump sum need arises such as health costs or funeral expenses. A microloan may be taken out to pay for these (probably with another, 'business' purpose for the loan given to the MFI) and then the cycle of indebtedness can begin. The idea in propounding the virtues of access to a range of financial services is that the poor can manage their uncertain income streams so as to avoid the large

[271] Naila Kabeer 'Is Microfinance a "Magic Bullet" for Women's Empowerment?: Analysis of Findings from South Asia' (2009) in ed. S Rajagopalan *Microfinance and women's Empowerment: A Critical Assessment* The Icfai University Press, p. 80
[272] Stuart Rutherford *The Poor and their Money* (2001) New Delhi; Oxford: Oxford University Press
[273] Op. cit. note 53
[274] Where households keep daily records of all their financial transactions, however minute, which are then shared weekly with researchers to build up a picture of the complex juggling of different sources of income and borrowing that is widespread.

item expense disasters that seem to freshly impoverish just when a household begins to claw its way out of extreme poverty.

Of course, the fact that it makes a lot of economic theoretical sense to think that providing financial access would enable poor households to smooth consumption and manage unanticipated disasters does not mean that we have empirical evidence that this is so. We no more have a randomised control trial to show that access to a suite of financial services leaves the poorest better off than those without, than we have proof of empowerment. It will be recalled that the two RCTs that have looked for evidence of empowerment as well as poverty alleviation, were unable to establish it. The case for financial access is an argument in logic rather than empirical fact thus far. Still, it is a good logic with limited downside: if the issue of security of savings can be resolved, access to a mix of savings, insurance and credit threatens to do much less harm than the sole use of credit to attempt to meet each of these needs.

Whether, at the macroeconomic level, it is the best use of the development dollar is a quite different question. Of course it would be a good thing for the poor to have access to financial services: it might be an even better thing for them to have access to free healthcare, clean water or a quality free education. No attempt is made here to judge the relative merits of each of these.

If this 'access to financial services works, even if microcredit alone has failed to' turns out to be true, then there is a role for microcredit as a part of that suite, even if rather a more modest one than its adherents had claimed for it. Its role may be made the greater if it is the part of that suite that is helping to pay for the rest: if it is hard to profitably/sustainably serve the poor with credit when high levels of interest are being charged, it is still harder with products such as insurance or savings where the immediate return on the product to the provider is much lower and greater volume (and a much longer timescales and higher client retention levels) would be necessary for the product to be profitably or sustainably offered.

Even if microcredit is justified, to some extent, as the bill-payer for a wider, more useful range of services (and this is not where the industry is yet) – even if this does end up on the 'plus' column for microfinance, we still need to weigh up, as far as we can, all the other pros and cons. It may be that even if microfinance did facilitate the provision of a broader suite of financial services, and even if that suite were effective in alleviating poverty and the worst downsides from the poors' lives, that the costs of microfinance were still too high to justify this.

In a recent interview with Tim Ogden, Banerjee and Duflo were blunt about the failures of microfinance in development.[275] Of the microenterprises themselves, Duflo comments: 'It's been obvious for a long time that these businesses are not growing. Grameen Bank has been around for many many years and their loans are still very very small. Just forget about subtle impact evaluation or whatever: it's been staring us in the face that these businesses are not growing, and the vast majority of people are not growing out of poverty or anything like that. If we had not been obsessed with the romantic idea of microcredit then maybe there would have been an earlier realizing of what microcredit does and what it can't do.'

Banerjee chimes in: 'The crisis in microfinance is a result of the 3 C's: Credulity, cupidity and corruption. The politicians were corrupt, we were all credulous, and the microfinance people were greedy. Put them together and you get the crisis. Our credulity was significant. Somehow we believed that all repayment happens in microfinance due to some magic which made no economic sense. We knew it didn't make economic sense…You don't need to do an evaluation to start asking questions. You just need to think about it for ten minutes. These are desperate people with lots of financial demands. People in the family are sick, people lose jobs, the daughter needs to be married…But 90 per cent repay. What is going on? How could we believe that this was because of some tweaking of economic incentives? As economists I think we were basically inept in thinking about it or we would not have believed it. The core fact [of coercive repayment loan enforcement] was staring us in the face…they come to your house, they call up your friends…And we didn't look at this, we evaded the gaze of these facts that were looking back at us.'

We can evade the gaze of these facts no longer. Chapter 10 discusses how we should respond to an intervention that has no proven positive impact on poverty overall, offers some evidence of empowerment, but also of disempowerment through the group liability model and has some, possibly significant gains for the few who make it, and some, utterly tragic consequences for some who do not.

[275] See http://www.philanthropyaction.com/articles/an_interview_with_banerjee_and_duflo_part_2

Chapter 10: The Distribution of Benefits and Burdens in Microfinance and What Can be Justified

Microfinance, then, has not been shown to have the clear positive impact on reducing poverty and empowering its borrowers that its proponents have claimed for it. But to conclude, of course, that it does not have net positive impact is not to conclude that it has no impact at all. On the contrary: we have seen that microfinance does enrich some, some of the time: but that it also has very negative impact when a borrower becomes overindebted, has a business failure or otherwise finds herself unable to repay.

This chapter asks: what type of distribution of these benefits and burdens is acceptable? And then it will attempt to quantify what the distribution of benefits and burdens actually is. But it is conceded at once that the answer to this second question is going to be sketchy at best. Because, by and large, the industry does not count its dropouts or measure what happens to them when or after they do dropout, the information on which to judge the negative burden is hardly there. If microfinance were a medical intervention, such a lack of knowledge of impact on the 'losers' from the intervention would be universally condemned. The microfinance world greets it largely in silence. However, what we do know will be drawn upon. First, however, it is possible to contemplate the type of distribution that we might find, theoretically, morally acceptable: and then consider, with the limited knowledge we do have, whether we are likely to be within the range of that.

An absolutist might take the position that a distribution of benefits and burdens resulting in net zero impact overall, but which includes severe losses, even suicides at the worst end, is straightforwardly unacceptable. Regardless of how the distribution falls between small scale negatives and small scale positives, with perhaps a few extreme winners, there should be no losses so bad borrowers are driven to suicide. As Harper[276] puts it, 'it is surely unacceptable that an intervention that is intended to help the poor should injure any of them.'

The approach taken here to weighing up the distribution of the benefits and burdens of microfinance is a consequentialist one. The problem for a consequentialist approach is that, in theory, if the totality of consequences are all that matter, then it would allow for some very

[276] Malcolm Harper 'Some Final Thoughts' in Thomas Dichter and Malcolm Harper (eds.) *What's Wong with Microfinance?* (2007) Rugby: Intermediate Technology Publications, p. 259

severe losses to a few if there were very many indeed who made some small, relatively trivial gain. There would be a distribution set – one suicide against ten million borrowers now able to afford tea daily for breakfast? or, less trivially, a million now able to send a child to school? – that the consequentialist has to accept weighs in favour of the small gains to the very many at the terrible cost to the very few. At this point the consequentialist starts to envy the certainties of an absolutist approach, which would not allow us to sacrifice even one for the small gains of millions.

There is a step some consequentialists take here to minimise the chances of endorsing the sacrifice of the few for a small gain of the very many, and that is to build in a weighting that favours the worst off: the prioritarian view.[277] Arneson[278] summarises this as 'according to prioritarianism, the moral value of gaining a benefit (avoiding a loss) of a given size for a person is greater, the lower the person's level of benefits (measured on an absolute rather than comparative scale) prior to the receipt of the benefit (avoidance of loss).'

By assigning an extra weight to losses taken by those below the poverty line, then, without altering the weighting given to the gains achieved by those who do gain from microfinance, the prioritarian consequentialist can argue that some distributions are unacceptable that the straight consequentialist would have to accept. But note that this has not really solved the problem. The prioritarian can reject the distribution that accepts one suicide for a million now having tea for breakfast: but whatever weight he has given the 'losers' here, unless it is infinite (in which case his position becomes that of the absolutist) then there will be a distribution (two hundred million having tea for breakfast?) that he will have to accept, unless he arbitrarily readjusts his weightings.

We need some guide as to how to weight. Parfit gives an example of two Hells.[279] In Hell One, 15 people suffer 100 years of agony, in Hell Two a billion people suffer one minute of agony. Total years of agony are higher in Hell Two than Hell One (1902 v 1500), but Parfit is clear that Hell One is worse because each of the 15 people suffer over fifty million times longer than those in Hell Two. So 15 x 50 million units of suffering is regarded as worse than one billion x one unit of suffering (even though in units it isn't) because we weight the fact that the 15 are so very much worse off. But by how much? Is 15 x 30 million units of suffering still worse than one billion x one unit of suffering? This is now less than half the

[277] See, e.g., Derek Parfit 'Equality and Priority', (1997) *Ratio* 10 (3) pp202-22
[278] Richard Arneson 'Egalitarianism and Responsibility', (1999) *Journal of Ethics* 3: pp. 225-247
[279] Derek Parfit 'Another Defence of the Priority View', (2012) *Utilitas* vol. 24 Special Issue 03 pp. 399-440

total suffering in Hell Two, but 15 people are still getting 30 million more times of it than any one of the billion in Hell Two. It is not clear where the lines get drawn.

The prioritarian position has a great intuitive appeal, but it is unclear how to assign the weights, and there will always be a further distribution set possibility that will produce the outcome the prioritarian seeks to avoid. However, it seems likely that once we calculate carefully for the actual utility gained and lost for the gain or loss of a given amount of income for those around and below the poverty line, the straightforwardly calculating consequentialist may well achieve the same result as the prioritarian without the need for arbitrariness in weighting. That a gain or loss of a given amount of income can have a very different impact on utility depending on the circumstances in which it arises was pointed out by Bentham in his original description of utilitarianism. He notes[280] 'it is manifest, that there are occasions on which a given sum will be worth infinitely more to a man than the same sum would be at another time: where, for example, in a case of extremity, a man stands in need of extraordinary medical assistance: or wants money to carry on a lawsuit, on which his all depends…In such cases, any piece of good or ill fortune, in the pecuniary way, might have a very different effect from what it would at any other time.'

What is argued here is that a key 'circumstance' that affects the utility of a gain or loss of a given sum to a person is the level of poverty from which that person starts. Whilst the overall impact of microfinance as poverty alleviator and empowerer appears (at best) balanced, with total income gained being roughly matched by total income lost, the total consequences are not measured solely and only by a household income measure. For a population hovering around and below the poverty line, the consequences of a gain or loss of, on average, say 30c a day are not equal. The gain is certainly a positive, and at this level of income the problem of running in to the law of diminishing marginal returns is perhaps still some distance away: but the consequences of losing 30c a day are disproportionately higher than the positives of the gain. This is because at this level, not very many steps down in income will lead to a lack of ability to survive at all. The gain may mean a household can move from eating twice a day to perhaps eating three times a day; or perhaps from having no breakfast to having tea in the mornings. Worthwhile gains enough: but the equivalent loss of 30c a day may mean actual starvation.

[280] Jeremy Bentham, *An Introduction to the Principles of Morals and Legislation* (1970) ed. J H Burns and HLA Hart London: Athlone Press p. 59

In other words, at and below the poverty line, and increasingly the further below it is gone, the disutility of a loss of a given sum is much greater than is the utility value of a gain of the same sum. This is clear when we think of what that sum could buy or no longer buy if lost. Going from two to three meals a day is an important benefit and could add some years to a person's life. But going from two meals a day to one will lead to serious malnourishment if not starvation and the loss of many years, perhaps all, of expected life.

Including the utility function and disutility function, expressed in welfarist terms of those in poverty effectively weighs the consequences in the way the prioritarian would want to. In Parfit's original discussion of prioritarianism,[281] each unit of benefit is equal: if someone rises from 99 to 100, he benefits as much as someone who rises from 9 to 10. In the case of microfinance, and the provision of it to those in poverty, we are making the opposite assumption: that (a) the law of diminishing marginal returns means that someone who rises from 99 to 100 does indeed get less benefit than someone who rises from 9 to 10; and that, more importantly, for the opposite burden, falling from 10 to 9 when 10 is already survival-critical, has much higher disutility than falling from 100 to 99: and that when 10 is the poverty line, the disutility of a fall from 10 to 9 is greater than the utility of a gain from 10 to 11.

The welfare consequentialist would take the measures of the impact of microfinance in terms of household income (which combine to a net zero impact) and translate these gains and losses in income into the impact on the welfare of the borrowers.[282] At this level of poverty, the negative impact on welfare of the loss of even a relatively small sum of income is greater than the positive impact on welfare of the same sum gained, leaving the consequentialist also rejecting a distribution of the benefits and burdens of microfinance that includes significant losses as well as significant gains.

So what do we know about the actual distribution of benefits and burdens?

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[281] Derek Parfit *Reasons and Person* Oxford University Press 1984, pp. 67-86

[282] This thesis will not attempt to do so, but one obvious unit of welfare measurement that could be used here would be the number, or fraction, of Quality Adjusted Life Years (QALYs) a marginal difference in income could effectively buy at each and every level of poverty, the idea being that a gain from 99 to 100 for a person already on 99 would buy rather fewer additional QALYs than a fall from 10 to 9 would cause a person already on 10 to be lost.

One study indicates that the burdens are relatively more likely to fall on those least able to bear them. Hulme and Mosley[283] drew on a study of thirteen financial institutions in seven countries, in Asia, Africa and South America. They analysed the impact of a loan on the income of a borrower and charted that against her starting level of poverty, that is, where she was relative to the poverty line at the point of taking out the loan. They found that the benefit of credit was greatest to those just above the poverty line (100 – 150% of it), who saw improvements to income of around 10%. Borrowers who were 'upper poor', with starting incomes 200% of the poverty line, saw much lesser gains. Most problematically, those who when they borrowed were *below* the poverty line saw their income *reduce*, and the poorer they were, the worse this was. The business failures (estimated at 15%) were disproportionately amongst those who were poorest to begin with, and suffer the greatest disutility from any given loss.

We need to understand just how many 'losers' from microfinance there are, and by how much they lose, both financially and in terms of disempowerment. Unfortunately, this is where we run into the paucity of studies that follow up dropouts to measure what the eventual impact on them of having engaged in microfinance was.

There is no clear single number we can point to, to measure the 'losers' from those who take up microcredit. Candidates are the repayment rate; the different number of those who do, individually, in fact default; the numbers who drop out; and the numbers who (if we could only measure it accurately) become over-indebted and choose or are forced to make serious sacrifices to repay their loans.

The repayment rate we know not to be an accurate measure of 'losers', because we know that a greater number in fact default, but their group then makes the sum up (even if it is sometimes coercively reclaimed from the borrower's assets). A better number would be the ratio who do in fact default on their loan, whether made up by the group or not, but even that is not a pure measure (it may potentially overstate), because some borrowers may choose to default when in fact they could comfortably continue to pay. There are also some who may 'strategically' default – they are able to repay their loans, but can see one or more members of their group who are struggling badly and will be obliged to default, leading the MFI to call upon the savings of the successful borrowers to make good the missed payments. If enough in

[283] David Hulme & Paul Mosley 'Finance for the Poor or Poorest? Financial Innovation, Poverty and Vulnerability' (1996) *Discussion Papers in Development Economics* Series G vol. IV

the group are struggling, and it is early enough on in a repayment cycle that the sum of the non-struggling borrowers' balances outweigh the savings they stand to lose, then a mass default by the whole group is a rational response by the non-struggling borrowers to limit the damage to them personally. Such instances are rare, but can be expected to occur when there is a general repayment crisis, caused either by local events such as economic downturn, famine, failure of crops or even government advice that it is not necessary to repay loans, as happened in Andhra Pradesh in 2010.

However this may be, individual default ratios are not released by MFIs, so we cannot measure the number of 'losers' this way. The next-best option is the number who drop out: the proportion of borrowers who decide not to carry on borrowing with an MFI.

Although MFIs do not regularly disclose dropout numbers, some studies have been done, and as we saw earlier, ratios of 25-60% were found in East Africa and around 15% in Bangladesh[284]. The drop out number then needs further modification before it can be our 'losers' number however. In theory, some borrowers will drop out because the MFI has served its purpose and the business has been so successful the borrower graduates on to a full banking relationship with a bank. One rarely sees this great success however, and it would surely be trumpeted by the MFIs whenever it did occur (every other possibility of success is). More likely, some borrowers will drop out from an MFI's programme because it disappoints in terms of its delivery, or the loan officers are not liked, or because the weekly meetings become too time consuming.

Some will also leave because the MFI's loan repayment schedule is inconvenient or they can get a better rate elsewhere. However, the number will also *under-estimate* because there may be many struggling borrowers who are losing money but do manage to stay within the group. They may sell assets or take in other borrowing just to avoid default and its consequences. Rosenberg and Schicks[285] have recently tried to examine how many borrowers become over-indebted by microfinance and would have been better off if they had never availed themselves of it, roughly what is being sought as 'losers'. They begin by summarising the recent problem: 'In a review of four countries, Chen, Rasmussen and Reille[286] reported that delinquent loans, which averaged 2 per cent of portfolio in 2004, skyrocketed to 2009 levels

[284] Op. cit. notes 205 and 206
[285] Richard Rosenburg and Jessica Schicks 'Too Much Microcredit? A survey on the Evidence of Over-Indebtedness' (2011) Washington D.C.: CGAP Occasional Paper no. 19
[286] Greg Chen, Stephen Rasmussen, Xavier Reille, 'Growth and Vulnerabilites in Microfinance' (2010) Washington D.C.: CGAP Focus Note 61

of 7 per cent in Bosnia-Herzogovina, 10% in Morocco, 12 per cent in Nicaragua, and 13% in Pakistan. In some of these countries, subsequent levels have been quite a bit higher. More recently, collection has collapsed in the Indian State of Andhra Pradesh.' We can add to this list David Roodman's[287] recent work on Grameen Bank, which puts loans 30 days past due and including rescheduled loans at 9.9%.

Rosenberg and Schicks examine this prepayment problem from the borrowers' perspective. Roughly, they define borrowers as over-indebted 'if they have serious problems repaying their loans'. 'Serious' is later fleshed out as when a borrower 'is continuously struggling to meet repayment deadlines and structurally has to make unduly high sacrifices related to his/her loan obligations. Especially in the context of an industry that says its purpose is to help the poor, microborrowers who manage to repay only by sacrificing minimum nutrition levels or their children's education should be counted as over-indebted.'[288] They note:

> Overindebtedness often implies heightened vulnerability and further impoverishment of borrowers. Material effects include reduced consumption levels, late fees, asset seizures, downward spirals of ever-increasing debt, and eventually, a loss of creditworthiness. There are sociological effects related to peer pressure and a loss of social position, as well as psychological effects on mental and physical health. In extreme cases, borrowers' desperation can even lead to suicide.[289]

Rosenberg and Schicks are not able to quantify the actual level of over-indebtedness in most markets. But they are concerned because 'Today there is less confidence in assertions that microcredit can raise millions of people out of poverty. The actual benefits may be considerably more modest. If the quantum of benefit we expect is lower, then the potential downsides for clients that we're willing to tolerate should be lower.'

Rosenberg and Schicks located six field studies that try to quantify microcredit over-indebtedness. It is a skewed sample, because the markets studied were chosen just because local observers were worried about over-indebtedness problems. Even allowing for this, they found the results worrying.

Gonzalez's[290] study in Bolivia – using quite a wide definition of over-indebtedness as drawing down on savings or working overtime at any point over a four year period – found

[287] David Roodman 'Grameen Bank Portfolio Keeps Deteriorating' on David Roodman's Microfinance Open Book Blog, 16 April 2012, available at http://blogs.cgdev.org/open_book/2012/04/grameen-bank-portfolio-continues-deteriorating.php, accessed 12.09.12.
[288] Op. cit. note 285 p. 23
[289] Ibid.
[290] Adrian Gonzalez 'Microfinance, Incentives to Repay, and Overindebtedness. Evidence from a Household Survey in Bolivia.' (2008) Doctoral thesis, Ohio State University, Ohio, p. 1

that 85% of people were overindebted. Grammling[291] in Ghana, defining over-indebtedness as having to draw down on non-business assets to keep up microloan repayments, found 12% of borrowers to be over-indebted and 16% at serious risk of becoming so. In a restricted-distribution study of a thousand microborrowers of half a dozen institutions in a country simply labelled X, over-indebtedness was defined as debt servicing costs being in excess of 100% of net income. 17% were classified as overindebted and another 10% as at risk of becoming so, with the poorer clients the most at risk of becoming overindebted.

In a peculiar study in Karnataka, India,[292] there had been several mass defaults, largely by Muslims, in certain particular towns where local Muslim organisations banned Muslims from continuing contact with MFIs. Comparing the mass default towns to the non-default towns, 21 per cent against 3 per cent said repayment was a burden; 34% against 2 per cent said they had skipped important expenses, such as meals. Rosenberg and Schicks can only speculate as to how far these defaulters were acting opportunistically in an agitated political atmosphere and how far this skewed the defaulters' accounts of their sacrifices. Note, as mentioned earlier, these defaults may have been less opportunistic than rational if borrowers thought their savings were about to be called upon to make up others' defaults. Embarrassment about admitting that as a motive may also have skewed the extent of the sacrifices they claimed to have been making.

Finally, Guérin et al[293] conducted a study in Tamil Nadu, India, that defined over-indebtedness as a process of impoverishment through debt, distinguishing three different levels:

(i) Transitional over-indebtedness: debt servicing is high enough to prevent accumulation of assets, but no worse; average debt levels are 1.4x annual household income.

(ii) Pauperization: despite asset sales, debt levels continue to rise, just to service existing debt and ensure household survival. There is no realistic prospect of the debt being met long term, but for a while it is continually re-charged. Average debt levels are 3.2x household income.

[291] Mattias Grammling 'Cross-Borrowing and Over-Indebtedness in Ghana: Empirical Evidence from Microfinance Clientele and Small Enterprises.' (2009) Technical draft for discussion. Frankfurt: Procredit Holding.
[292] Karana Krishnaswamy and Alejandro Ponce 'A preliminary analysis of mass defaults in Karnataka, India.' (2009) Presentation slides, quoted by Rosenberg and Schicks op.cit. note 286.
[293] Isabelle Guérin, Marc Roesch, Venkatasubramanian, Santosh Kumar, 'The Social meaning of over-indebtedness and credit worthiness in the context of poor rural South India households (Tamil Nadu)' (2011) *RUME Working Paper Serie* 2011-1, Paris, IRD

(iii) Extreme dependence – households have no prospect of repayment, rely on kin support and charity for daily survival.

Of the original sample of 344 households, Guérin et al only studied the most indebted 20 per cent in detail. Of these, 19 per cent were in 'transitory over-indebtedness'. 38% were cases of 'pauperization' and 43% suffered from 'extreme dependence'. The entire worst 20 per cent would count as overindebted, then, and Rosenberg and Schlicks note that 'The findings suggest that over-indebtedness is also prevalent among households that didn't fall into this subsector. Twenty per cent is therefore the absolute minimum estimate for overall over-indebtedness in the original sample.'[294]

In the absence of hard evidence, definitive conclusions are impossible, and we must take what evidence we have. Taking the evidence of the early Hulme and Mosley survey, the indebtedness surveys (serious indebtedness of 20% and up, albeit in places known to be problematical), the numbers that regularly drop out (10 – 65%) and the percentage of Grameen Bank loans known to be past due or rescheduled (10%), it seems reasonable to suggest that there are at least 10%-20% of microfinance borrowers whose lives go worse from having borrowed, with the percentage peaking at very much higher levels when credit has become too easily available in a market and overborrowing has occurred. Given that the RCTs that have been carried out that did include drop outs (as the Spandata study did) showed no overall positive net impact, and that we know that most enterprises do not flourish much because of their failure to expand, it would follow that to offset these hidden losers, the few winners must be doing quite well indeed.

The distribution of the benefits and burdens of microfinance, on the patchy evidence we have, appears to be that at least a significant minority, more in credit bubbles, are losing significantly and these are typically poorer borrowers for whom disutility from the loss is highest. There is a large majority to whom not much difference is made, and a small number of 'winners' who really do relatively well.

The BBC reporter Mukul Devichand observed this rather more anecdotally when he visited a joint liability group of ten women in the slum of Navodhya Nagar in Hyderabad. Of these ten, one was in severe debt, one's business was 'a flop' and two had 'man-trouble' – one's husband had run off with her loan and another's drank the money away. Five were not

[294] Op. cit. note 285 p. 28

observing much difference in their lives. The remaining one who was had started a sari trading firm and was now building a grand new home on the lake.[295]

The pattern that out of a group of ten, you might have one significant winner, five indifferents, three losers and one very significant loser, is not a distribution that would be acceptable to either the absolutist or the consequentialist This is particularly so for the latter if household income impacts are translated into welfare impact, at which point the net zero income impact would likely translate into a net negative welfare impact.

Quite clearly, empirical research on the actual distribution of microfinance's benefits and burdens is badly needed. The above is only a sketch of what the distribution might be, but it is suggestive that most normative theories would find it unacceptable.

The conclusion considers what changes could be made to microfinance to help ensure both that it is practised ethically, and that its burdens and benefits fall in a more ethically acceptable fashion.

[295] 'The Bankers and the Bottom Billion', broadcast on BBC Radio 4 FM at 8pm on 17/5/2011.

Conclusions and Recommendations – How to Practice Microfinance Ethically

The paradox of microfinance is that it aims to increase the autonomy of its borrowers by empowering and enriching them: but that its practices undermine these aims, largely because borrowers are treated in aggregate rather than as individuals. It is ironic that an industry that to a considerable extent began its modern expansion with one man's cry against an individual woman and her children being condemned to a lifetime of penury for the lack of twenty-two cents in capital, should have made its targeting of credit and measuring of success on a group, aggregate basis. It is particularly because microfinance measures its success in terms of aggregate repayment rather than through individual outcomes that it has lost sight of what happens to the particular people it lends to. It has been an industry blinded to some of the negative consequences of its practices by its certainty of its own good intentions.

When the industry has at times acknowledged the negative consequences of its group lending practices, it has justified them by appealing to the consequentialist argument that, overall, borrowers have been made better off by their engagement with microfinance. We have seen from the evidence presented in Chapters 8 and 9 that this stance is not justified by the facts. Indeed, it seems likely that if the industry stuck to the emphasis on the individual and her autonomy that it has in its aims, within its practices, the consequences overall might be rather better. Through respecting individuals and their autonomy more completely in practice as well as in theory, the industry would move a long way towards cutting out the worst of what goes wrong. Seeking to improve individual rather than aggregate outcomes would be likely to improve aggregate outcomes as well by reducing the number of 'losers', those for whom borrowing makes life go very much worse, and for whom the disutility of loss is highest.

How could this be done?

It could be done by the industry improving its own self-regulation, or failing that, individual governments introducing regulation to achieve the same reforms.

The leading players of the microfinance industry set up the Smart Campaign in 2009 to focus on issues of client protection. It is here, if anywhere, that we can start to find industry policies aimed at preventing over-indebtedness and the charging of levels of interest rates (however defined) that will inevitably lead a client into a spiral of debt. The Smart Campaign does put forward seven Client Protection Principles (CPPs) which, it is claimed, 'address the mandate of all providers to treat clients fairly, with transparent and ethical standards that avoid harm.'[296]

The seven Client Protection Principles are: -

1. Fair & Respectful Treatment of Clients
2. Transparency
3. Prevention of Over-Indebtedness
4. Responsible Pricing
5. Appropriate Product Design and Delivery
6. Privacy of Client Data
7. Mechanisms for Compliant Resolution

The problem with these are two-fold. First, they are not specified. Just what does fair and respectful treatment of clients require? What level of interest rates would 'responsible pricing' disallow? Secondly, they are not enforced. Rather, an MFI can send the Smart Campaign a one-time signature to state that they endorse these principles, and then state on its publicity materials, web sites etc. that it is signed up to the Client Protection Principles of the Smart Campaign, and make no changes to its behaviour whatsoever. No one from the Smart Campaign will come to see if any of the Principles are followed, or how they are interpreted. If this is self-regulation, it is self-regulation with the regulation left out.[297]

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[296] Se www.smartcampaign.org

[297] As this thesis goes to the printers, the SMART Campaign has announced that from January 2013 it will introduce a certification programme for its CPPs. This will allows MFIs to apply to rating agencies, for a fee, for an independent certification that they do indeed comply with the CPPs. The standards that have to be met for each one to receive accreditation are still being agreed upon between the SMART Campaign's 'thought leaders' and the rating agencies.
At a meeting of the UK Microfinance Gateway Club on 27th November 2012, Beth Rhyne, who heads the SMART Campaign, stated that these standards would, on a scale from 'wrong/criminal' through 'unsavoury' to 'fit & proper' to 'excellent', sit on the borderline between 'unsavoury' and 'fit & proper'. The specifications are not yet on the website, but as an example of what would be good enough to count as 'fair' pricing, Ms Rhyne stated that it would be that an MFI charged roughly the same as others operating in that country. So if all MFIs in a country charged 60 – 80%, that would be 'fair'. With regard to transparency of interest rate, she was not sure if there would be a requirement for APRs or EIRs or not.
Specifying what it takes to meet the CPPS, and having independent verification of it, is progress of a sort. Without yet having the proposed set of specifications for the standards, it is not possible to see how far the

For self-regulation to have any meaning, for the CPPs to actually offer some protection to borrowers, the Smart Campaign needs to specify a standard for each Principle and then independently assess each MFI's attainment of that. What might such a specification be? Some ideas follow.

Client Protection Principle		Specification
Fair & Respectful Treatment of Clients		Individual lending (no group liability)
Transparency		APRs or EIRs for every loan
Prevention of Over-Indebtedness		APRs/EIRs, compared to recorded margins/cash-flow of client
Responsible Pricing		APR/EIR no more than (say)1.2x the Commercial/Urban/Formal rate
Appropriate Product Design and Delivery		No hidden charges; offering of savings facility alongside credit offering
Privacy of Client Data		Individually recorded
Mechanisms for Complaint Resolution		+ follow up on outcome for all clients and ex-clients, regardless of whether they drop out.

As will be seen from the above suggestions, for the industry to start taking client protection, its duty of care, seriously, it needs to do three things it currently regards as anathema:

1. End the use of group liability contracts. All lending should be with individual liability only. If lending is still made in groups, the practice of making future loans to individuals in groups also dependent on the group's repayment, must cease.

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industry has really moved in the direction of client protection: and it will be some time yet, even if it has, before we know how many MFIs sign up to be measured. The tenor of the discussion, however, was that the specifications will be pitched at the minimum possible level that could be described as an 'adequate duty of care' in order to achieve the broadest participation.
The biggest problem for the SMART Campaign and its specifications, however, is that it does nothing to tackle the problem inherent in the group lending methodology. As we have seen, some of the worst problems for borrowers who struggle come only indirectly from the MFI, but are enforced by other members of the borrowing group. None of the CPPs address this and none of the specifications of them will do so, according to Ms Rhyne. Thus, sadly, the certification programme could exceed all its currently rather low expectations and set excellent standards that are followed and verified: and the problems of disempowerment of borrowers observed in this thesis continue by proxy.

2. Introduce compulsory disclosure of the Annual Percentage Rate (APR) or the US Effective Interest Rate (EIR), so long as all MFIs use the same one. If MFIs want to continue to use flat rates, so be it, but the APR/EIR must be published alongside them, both so that the borrower has a truer idea of the cost of her loan, and for purposes of comparison. The APR/EIR must, of course, contain all charges.

3. Require record keeping from MFIs, by individual client, of the interest rate on the loan extended and either the margin of the proposed business, or the cash flow of the borrower if in fact it is to be used for consumption.

These three measures put the individual back at the heart of microcredit. They are what is required, at a minimum, for microcredit to be practised ethically.

Although the short term impact of implementing these on many MFIs' profitability may well be negative, in the long run it may turn out that these measures are in the MFI's interests as well. This could be so because, whilst MFIs may think that the use of group liability takes the debt repayment problems away from them and passes it on to the group – as in the short term it does – in practice there is a tipping point after which the entire group would default en masse and the credit problem reverts right back to the MFI. This occurs when group members who can make their interest payments and would lose their 20% 'compulsory savings' if they defaulted, realise that likely defaults in the rest of the group are going to exceed the combination of their and the other non-struggling members' total 'compulsory savings'. At this point, since they can see that they are going to lose that 20% regardless of their own performance, it is rational for them to cease repayment and keep the outstanding loan balance that they have, assuming that balance exceeds their compulsory savings. This pattern is only likely to occur when a serious bubble is building up in credit[298], but that is exactly when the MFI needs to know about it (and with group liability will not until it is too late) because its own solvency may be at stake.

If individual liability were implemented across the industry, as in developed countries, there would be an earlier, more persistent rise in loans past due payment, but as a credit bubble developed, this would begin to rise, acting as an early warning mechanism to the MFI and signalling to it to begin to curtail lending, or raise its credit standards. Doing so then would

[298] Or where there is some general economic factor that is causing the quality of all loans to deteriorate simultaneously, such as a general rise in basic food prices which reduced effective demand of the purchasers of the borrowers' goods, hitting all their sales.

serve to deflate the bubble, prevent worse over-indebtedness later on and serve both borrower and MFI interest.

It is, of course, the borrowers' interests we are most concerned to protect here, but if MFIs became convinced that these measures were actually in their business interest as well, that would certainly raise the chances of their being brought about.

What, though, if the industry continues to take the need to protect its borrowers as lightly as it has in the past? Could regulation help?

This thesis does not have space to discuss what regulation of microfinance there is, country by country. As a necessarily sweeping generalisation, if an MFI does not take deposits, it is not regulated at all: if it does, it will require a banking licence and will have to comply with local banking regulations. These largely, however, cover the level of capital and liquidity a bank must hold, as they are prudential regulations designed to protect depositors from losing their savings, not regulations aimed at protecting borrowers from predatory lending practices.

Regulation tends to be feared by MFIs as likely to introduce more expensive bureaucracy, as well as higher capital requirements many can ill afford. But some simple regulatory principles could be established wherever microfinance is practiced without requiring higher capital for non-deposit taking institutions. And these would be the same principles that could be introduced by MFIs through self-regulation:

1. Make group liability contracts legally unenforceable

2. Make publication of all fee inclusive APRs or EIRs compulsory

3. Require record-keeping of APRs/EIRs, margins and cashflows and audit them.

Naturally, there would be some cost to the MFI being required to implement these measures. Exactly the same cost as if they introduced them voluntarily: but, as argued above, they represent the best option for returning MFIs to their original goals of empowering and enriching their clients: and are quite possibly in their own long term interest well. Making publication of all fee inclusive APRs or EIRs compulsory can in fact help some MFIs, who are reluctant to do so not because they in fact charge more than others, but that by being the first to move to this method of calculating the interest rate, they will look as if they do.

Forcing all to employ good practice aids those who wish to but for competitive reasons, delay.

An additional idea for regulation is put forward by Hugh Sinclair,[299] a practitioner and consultant to the industry. This is that we consider regulating not just the MFIs, but the MIVs – Microfinance Investment Vehicles – which provide a large portion of their funding. Much simpler than assessing regulation country by country, the MIVs (firms such as Triple Jump, Oikokreditbank, Deutsche Bank) are concentrated in a very few countries – Switzerland, Holland, Germany and the US – where regulation might be thought easier to carry out. If, as was held in Chapter 3, those who make profit from investing in the MFIs are as much a part of the exploitation of the borrower as the MFI itself, then this could be a very effective route.

It could be, but one wonders what the incentive is for the Swiss or Dutch financial authorities to regulate a Blue Orchard or a Triple Jump. Regulation usually exists to protect borrowers in a country because they are that country's citizens, that government's voters. The Swiss government has no motive to regulate Blue Orchard's potential exploitation of a Zambian tomato seller. (It is not as if, unfortunately, the Swiss financial authorities have demonstrated especial alacrity in regulating the much more direct exploitation of illicit financial flows by Swiss banks.) Sadly, attractive though the idea is in theory, it is hard to see it being practised.

Much improved self-regulation is the more likely route for the microfinance industry to try if it wishes to bring its practices back into line with its ethical objectives, if only because the costs to individual governments of providing regulation may look prohibitive to them.

If the industry does decide on the improved self-regulation route, it might also consider a Code of Ethics that goes beyond the protection of the borrower's autonomy, important as that is, and looks to some of the other agents impacted by microfinance in addition to the borrower herself. Such might be:

1. No lending to business activities that are illegal. No lending for the production of moonshine which is then retailed on, the more especially in countries where there is a high correlation between drunkenness and the spread of AIDs. Money being fungible, loans should be made immediately repayable if a borrower is found to be undertaking such an activity,

[299] Hugh Sinclair, *Confessions of a Microfinance Heretic: How MicroLending Lost its Way and Betrayed the Poor* (2012) San Francisco: Berrett-Koehler

regardless of what she stated the purpose of the loan was for. This condition must of course be made known to her on taking out the loan. Another activity that might be included in this category is money-lending, the borrower essentially arbitraging the cheaper loan from the MFI to lend on at higher rates herself.

2. Do not lend to borrowers who use child labour.

3. Allow a grace period, and perhaps a rescheduling of the loan, in the face of the client facing an unexpected, but temporary, economic shock (as Grameen does).

4. Allow clients to 'rest' without penalty if a predictably busy time is approaching, such as the harvest season in rural subsistence economies.

5. Adopt the specification of the Client Protection Principles listed above, not just the Principles themselves.

Whether through self-regulation or through regulation imposed upon the industry, then, the industry needs to put at its heart its duty of care to the borrowers. It needs to place respect for the individual and her autonomy at the centre of its procedures and practices as well as its objectives. It should do so in fact whether the underlying philosophy of the practitioners or their regulators is one that gives autonomy a high intrinsic value or simply a high instrumental one. For those placing an absolute value on autonomy, it is straightforward: the industry simply needs to practise what it preaches. This thesis has given autonomy a high value, but not an absolute one. But even for a pluralist or consequentialist approach, the practical outcome is much the same. If the industry puts respecting individual autonomy at the heart of its practices as well as objectives, it is likely to reduce the worst outcomes carrying the highest disutility for borrowers for whom microcredit exacerbates rather than alleviates poverty. In doing so it is likely to also achieve the greatest positive, net, outcome for all.

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